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ABSTRACT

As part of a study of the Vocational Education Act (VEA) (see note), the clarity, consistency, and adequacy of the VEA fiscal requirements were examined. Six statutory provisions were identified. Three of these provisions govern the distribution of federal VEA funds from the state to local recipients: the application approval priorities, which require that states give priority to applicants proposing new programs located in depressed areas; the two funds distribution factors which states are to use to distribute VEA funds to applicants; and the additional priorities which states in funding certain programs are to give to applicants. The other three statutory provisions, in turn, affect the distribution of non-federal funds for vocational education: the matching requirements; the requirement that states and recipients maintain their efforts with respect to the aggregate amount of VEA funds received by each: and the non-supplanting provision which requires that VEA funds be used by states and recipients so as to ensure that federal funds supplement non-federal funds. Four major issues which cause problems in regard to the federal interpretations and state implementation of these fiscal requirements were identified in the study. They are (1) whether the statutory language describing application priorities is clear and adequate; (2) whether the provision specifying two funds distributions factors to local recipients is clear enough so that Congress's goals of equalizing the availability of vocational education resources can be realized; (3) whether the legal framework gives adequate guidance with respect to priority criteria and funds allocation; and (4) whether the legal framework contains adequate standards with respect to the interrelationship between federal VEA funds and funds from other sources used for vocational education programs. (KC)

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VOLUME 2

AN ANALYSIS OF THE FISCAL AND EQUITY PROVISIONS OF THE VEA

PART III: AN ANALYSIS OF THE FISCAL PROVISIONS OF THE VEA

Prepared by

Long and Silverstein, P.C.
1725 Eye Street, N.W.
Suite 503
Washington, D.C. 20006
(202) 466-7550

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PREFACE AND ACKNOWLEDGEMENTS

This is Volume 2 of a paper prepared by Long and Silverstein, P.C. for the National Institute of Education entitled An Analysis of the Fiscal and Equity Provisions of the VEA. Volume 2 contains Part III of the paper (an analysis of the fiscal provisions). Volume I, which is separately bound, contains Part I (an introduction to the research), and Part II (a summary of the major findings and conclusions). Volume 3 which is also separately bound contains Part IV (an analysis of the equity provisions of the VEA) and Part V (an analysis of the incentives, oversight mechanisms and sanctions).

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CHAPTER 1

SUMMARY OF PART III

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CHAPTER 1

SUMMARY OF PART III

I. Introduction

A. Purpose and Organization

The purpose of this chapter is to provide a brief overview of the research conducted on the VEA fiscal requirements in the four states in our sample.

This chapter is divided into three sections. This introductory section (I) provides an overview of the VEA legal framework and the major substantive fiscal issues raised by the fiscal provisions and outlines the organization of these issues in chapters 2 through 5 of this part.

Section II of this chapter contains a glossary of the basic terms used in this report, including essential statutory, school finance and technical formula terms. Section III summarizes our major findings, conclusions and recommendations with respect to the fiscal issues.

B. Overview of the VEA Legal Framework and the Substantive Issues

This part of the report examines the clarity, consistency and adequacy of the VEA fiscal requirements. Six statutory provisions are examined in this part.

Three of the statutory provisions govern the distribution of Federal VEA from the state to local recipients:

(1) the application approval priorities, which require that states give priority to applicants which propose new programs and which are located in economically depressed areas;

(2) the two funds distribution factors which states are to use to distribute VEA funds to applicants: the relative financial ability of each recipient and the relative concentration of either low-income families or individuals (for LEAs) or higher cost students (for other eligible recipients);

(3) the additional priorities which states in funding certain programs are to give to applicants (i.e., applicants which have high dropout, youth unemployment, or are located in economically depressed areas).

The application approval criteria and fund distribution factors were added to the VEA fiscal requirements through the 1976 amendments. The Senate proposed these application approval priority criteria with the expectation that they would assist states to equalize educational opportunity, to focus on high need recipients and programs, and to make hard choices among competing applicants for scarce Federal funds. These application approval priorities of the Senate bill were included in the final bill verbatim as section 106(a)(5)(A).

The House proposed the mandatory funds distribution factors to give greater specificity to existing congressional concern to provide more funds to the school districts and agencies "most in financial need of these funds." The House sought to remedy the situation found in 1976 in which "states are not following the intention of the legislation" with respect to the equalization function of Federal funds. These factors were included verbatim in the Act as section 106(a)(5)(B)(i).

The prohibition against certain funding methodologies was carried over from the prior VEA with additional specificity; and the additional priorities applicable to specified uses were carried over without change.

This part also analyzes three provisions of the VEA which affect the distribution of non-Federal funds for vocational education:

(1) the matching requirements, which require a dollar-for-dollar match of state or local funds to the aggregate Federal VEA funds; and reduced matches applicable to certain sections of the VEA;

(2) the requirement that states and recipients maintain their effort with respect to the aggregate amount of VEA funds received by each, as well as the specific maintenance of effort requirements applicable to particular uses of VEA funds; and

(3) the non-supplanting provision which requires that VEA funds be used by states and recipients so as to ensure that Federal funds serve to supplement the non-Federal funds available for VEA uses.

These provisions were also part of the preexisting legal framework and were amended to a relatively minor extent in 1976 and in later technical amendments.

Despite Congress' concern with the precision and clarity of the fiscal requirements, we found them to remain a central focus for much of the controversy over the VEA. Our research into the Federal interpretations and state implementation of these fiscal requirements has identified specific features of the VEA legal framework that have caused problems, frustrating the achievement of the goals of the VEA.

We have identified four major issues:

(1) whether the statutory language describing application priorities is clear and adequately prescriptive to direct states in giving priority to applicants;

(2) whether the provision specifying two funds distribution factors to be used by LEAs and OERs is sufficiently precise so that Congress' goals of equalizing the availability of vocational education resources among recipients can be realized;

(3) whether the statutory legal framework gives adequate guidance with respect to the mechanisms states are to use to utilize the applicant priority criteria and the funds allocation factors; and

(4) whether the legal framework contains adequate standards with respect to the interrelationship between Federal VEA funds and funds from other sources used for vocational education programs.

Each of these is addressed in a separate chapter in this part of our report.

The first of the major fiscal issues, the meaning of the application approval and other priority considerations specified in the VEA, is the subject of Chapter 2. Chapter 2 describes and analyzes the clarity of the definition and measurement of each of the statutory priority concepts: (1) economically depressed areas; (2) new programs; and (3) "additional" priority for areas with high school dropouts and youth unemployment. It also evaluates how these considerations are measured and included in the state distribution process so as to "give priority".

Chapter 3 evaluates the Federal legal framework's required "funds distribution factors": relative financial ability and low income/higher cost students. This chapter evaluates the adequacy of the two statutory categories of recipients for purposes of funds distribution:"local educational agencies", and "other eligible recipients". It also analyzes each of the distribution factors for clarity, comprehensiveness and consistency with congressional funds distribution objectives.

The requirements for the design of formulas for allocating VEA funds among eligible recipients and the relationship between the application approval and funds distribution requirements are the subjects of Chapter 4. In this chapter, the mechanisms through which these criteria and factors operate are described and analyzed. The Federal administrative framework, which permits applicants to combine application approval and funds distribution requirements in a unified formula (the "one-step process") or to separate these provisions into an application review stage and a funds distribution stage (the "two-step process") is evaluated with reference to the diverse funding formulas, mechanisms and methods employed by states.

Chapter 5 addresses the issues raised with respect to fiscal standards governing how state and local funds interrelate with VEA funds. The various provisions which require a matching of VEA funds, maintenance of fiscal effort and the use of VEA funds so as to supplement and not supplant are described and analyzed.

II. Glossary of Fiscal Terminology

This part utilizes a number of terms which may be unfamiliar to lay readers, or which may be understood to communicate a different concept in another context. This glossary defines terms which are: (1) part of the VEA fiscal terminology; (2) terms used to explain functional aspects of formulas; and (3) terms which are used to describe public school finance concepts.

A. VEA Terms

The VEA contains its own referents to fiscal requirements or concepts which are used repeatedly in an abbreviated form to discuss the statutory fiscal requirements.

Application Approval Priority Criteria: The VEA, as amended in 1976, requires that states give priority to applicants on the basis of two criteria described in the statute. Sec. 106(a)(5)(A) of the VEA (20 U.S.C. 2306(a)(5)(A)).

Funds Distribution Factors: The VEA, as amended in 1976, requires that states distribute VEA funds on the basis of social, economic and demographic factors and prescribes the two most important factors. Sec. 106(a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

Uniform Percentage Match: This is a method of distributing funds to recipients, which gives to each recipient an amount equal to the product of an unvarying percentage times a recipient's actual expenditures (or calculating the percentage of local matching funds the recipient is required to provide). This method of distribution is prohibited by the VEA. Sec. 106(a)(5)(B)(ii) of the VEA of 1976 (20 U.S.C. 2306(a)(5)(B)(ii)).

Flat Per Capita Allocation: This is a method of distributing funds to recipients which allocates a set dollar amount for each pupil enrolled or in attendance. This method of distribution is prohibited by the VEA. Sec. 106(a)(5)(B)(ii) of the VEA (20 U.S.C. 2306(a)(5)(B)(ii)).

Local Educational Agency (LEA): A board of education or other legally constituted local school authority having administrative control and direction of public elementary or secondary schools in a city, county, township, school district, or political subdivision in a State, or any other public educational institution or agency having administrative control and direction of a vocational education program. Sec. 195(10) of the VEA (20 U.S.C. 2461(10)).

Area Vocational Technical Schools (AVTS') (also called area vocational education schools):

> **(A) a specialized high school used exclusively or principally for the provision of vocational education to persons who are available for study in preparation for entering the labor market, or**

> **(B) the department of a high school exclusively or principally used for providing vocational education in no less than five different occupational fields to persons who are available for study in preparation for entering the labor market, or**
> **(C) a technical or vocational school used exclusively or principally for the provision of vocational education to persons who have completed or left high school and who are available for study in preparation for entering the labor market, or**
> **(D) the department or division of a junior college or community college or university operating under the policies of the State board and which provides vocational education in no less than five different occupational fields leading to immediate employment but not necessarily leading to a baccalaureate degree, if it is available to all residents of the State or an area of the State designated and approved by the State board, and if, in the case of a school, department, or division described in (C) or (D),** it admits as regular students both persons who have completed high school and persons who have left high school. Sec. 195(2) of the VEA (20 U.S.C. 2461(2)).

State Educational Agency (SEA): The State board of education or other agency or officer primarily responsible for the state supervision of public elementary or secondary schools, or, if there is no such officer or agency, an officer or agency designated by the Governor or by state law. Sec. 195(11) of the VEA (20 U.S.C. 2461(11)).

Post-secondary Education Institution: A nonprofit institution legally authorized to provide post-secondary education within a state for persons sixteen years of age or older, who have graduated from or left elementary or secondary school. Sec. 195(12) of the VEA (20 U.S.C. 2461(12)).

Eligible Recipient: Under the VEA, local educational agencies and post-secondary educational institutions are eligible to receive VEA funds through the state's distribution process. Sec. 195(13) of the VEA (20 U.S.C. 2461(13)).

Low-Income Family or Individual: Families or individuals who are determined to be low-income according to the latest available data from the Department of Commerce. Sec. 195 (17) of the VEA (20 U.S.C. 2461(17)). This statutory definition has been broadened by ED interpretation because of problems discussed in Chapter 3.

Cooperative Education: A program of vocational education for persons who, through written cooperative arrangements between the school and employers, receive instruction including required academic courses and related vocational instruction by alternation of study in school with a job in any occupational field, but these two experiences must be planned and supervised by the school and employers so that each contributes to the student's education and to his or her employability. Work periods and school attendance may be on alternate half days, full days, weeks, or other periods of time in fulfilling the cooperative program. Sec. 195(18) of the VEA (20 U.S.C. 2461(18)).

Matching: This refers to a requirement that the state or a recipient contribute a set amount or percentage of their own funds in order to receive Federal funds.

Maintenance of Effort: A requirement that the state or recipient not spend less from their funds for a certain purpose than was spent in a prior year as a condition to receiving Federal funds.

Non-Supplant: A requirement that a state or a recipient apply Federal funds to fund program activities so as to increase funds available, and prohibits a shifting of non-Federal funds from this purpose because of the receipt of Federal funds.

Economically Depressed Area: This has two meanings in the VEA legal framework: (1) one of the priority criteria states are to use for approving applications (Sec. 106(a)(5)(A) of the VEA (20 U.S.C. 2306(a)(5)(A)) and (2) a composite measure of economic indicators compiled by the Department of Commerce.

AFDC: (Aid to Families with Dependent Children) The Federal welfare funds passed through states to provide funds to low-income families. The number of such families is used as a proxy for low-income.

Relative Financial Ability (RFA): One of two funds distribution factors specified in the VEA which is measured by property wealth or total tax effort per capita. Sec. 106 (a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

Property Wealth: A ratio which expresses the relationship between the taxable local property (available for education financing purposes) and the number of persons or students in a school district or post-secondary institution. This is one of the two measures of "relative financial ability" permitted by ED, discussed in Chapter 3.

Higher Cost Students: One of the two funds distribution factors applicable to other eligible recipients which measures the concentration of children served in the institution whose education imposes higher than average cost. Sec 106 (a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

School Lunch Count: This counts the number of children eligible to receive free and reduced price lunches which are subsidized by the Department of Agriculture. This is sometimes used as a proxy for low-income students under Section 106(a)(5)(B)(i).

B. Formula Terms

Federal administrators have required states to use a formula as the mechanism for distributing funds among eligible recipients. As noted in the introduction to ED's draft funds distribution manuals, states use a variety of, often complicated, formula devices to distribute VEA funds. Listed below are terms used in this report to describe and analyze these formulas.

Weightings: Refers to the practice of multiplying a formula factor by a whole number or a fraction to adjust the relative effect of that factor in the formula, e.g., to take into account the higher costs of educating certain students such as handicapped or disadvantaged.

Ranking: A process of arranging recipients in a descending order on the basis of formula scores. Can be either discontinuous or continuous.

Scaling: (1) The practice of converting raw factor numbers into a numerical form in order to compare applicants on each factor and to combine factors having different raw numbers; and (2) the arithmetic method used to convert each recipient's total factor scores into the amount of VEA funds each recipient will receive. These can be either continuous or discontinuous.

Continuous Scaling: A type of scaling which converts the raw numbers into a different expression of its value but retains the actual range of variance between factors. For example, converting raw scores expressed as 100, 57 and 12, to factors of 10, 5.7 and 1.2.

Discontinuous Scaling: A type of scaling which converts raw numbers into a different expression of its value which does not retain the actual range of variance between factors. Quartiles, in which the full range of raw numbers is assigned to one of four scaled values (*e.g.*, 1, 2, 3 or 4), is an example of discontinuous scaling.

Scale Parameters: Legal standards governing the methods used by states to scale formula factors. Examples of possible parameters include a requirement that continuous scales be used; or a requirement that ratio of lowest to highest numbers on a formula scale be not less than the ratio of the highest to lowest raw factor scores.

Funding Pool: A separate portion of the total fund of money for which applicants may chose to separately apply. An applicant for funds from a funding pool is approved on the basis that the applicant agrees to use funds for a specified purpose.

Set-Aside: A set-aside is a specified portion of a total amount of funds that an applicant must agree to use for a certain purpose or in a certain manner. Unlike the funding pool, the set-aside is mandatory rather than optional. The term "set-aside" is also used in Part IV of this report to describe the minimum percentages the state must set aside for national priority purposes (i.e., handicapped, disadvantaged and post-secondary students).

Direct Allocation Method: A method of funding under which fund distribution factors directly determine the amount of VEA funds an applicant is entitled to receive under an approved application.

Percentage Reimbursement Method: A method of distributing funds to recipients which gives to each recipient an amount of VEA funds equal to the product of a variable percentage times a recipient's actual expenditures for vocational education or a particular vocational service or cost element, e.g., teachers salaries, equipment. This method is used both to calculate a direct entitlement for recipients and in conjunction with the project method. In some cases this method may calculate a percentage local match; however, the effect is the same as if the percentage of VEA funds were calculated. (See also "Uniform Percentage Method", above.)

Project Method: A method of funding under which approved applicants or eligible recipients are ranked based on fund distribution factors and applicants are funded in the order of the ranking.

ADA: Abbreviation for the average number of pupils in daily attendance.

ADM: Abbreviation for the average daily membership which is the average number of pupils enrolled in a school district.

Full-Time Equivalents: A method of counting full-time and part-time students which avoids "overcounting" part-time students. Units, such as course contact hours or pupil minutes, are counted and converted to the equivalent of a full-time student. Full-time equivalent student measures are used to compare more accurately the relative size of vocational programs among LEAs and institutions.

C. School Finance Terms

The 1976 Congress clearly indicated its concern that Federal funds be used to equalize for disparate fiscal abilities among recipients. Congress required that the "relative financial ability" of recipients be one of the "two most important factors" in distributing funds among recipients. In describing how states have measured this term and in analyzing the comprehensiveness of the Federal administrative interpretations, we use terms which are commonly used to describe and analyze the public school financing systems.

Equalization Formula Aid: Financial assistance given by higher level government (i.e., state or Federal) to equalize for the differing fiscal abilities of lower-level governments. In general, equalization formula aid increases as the per-pupil or per capita property wealth of a school district decreases.

Categorical Programs: State or Federal aid that is designated for specific purposes or programs.

Flat Grant Program: Allocates an equal sum of dollars per student to recipients.

Pupil-Weighted Systems: An aid system in which pupils are given different weights based on the estimated or assumed costs of their educational programs.

Local School Property Tax Rate: Usually the amount of property tax dollars to be paid per unit of assessed valuation of property which is subject to the local school property tax. It is often expressed as "mills" which indicates how many dollars of tax are paid per $1,000 of assessed valuation.

Equalization: This term has numerous meanings applied to school finance depending on the group from whose perspective it is measured. Equity for children is typically measured by inputs (i.e., resources available to children) but some would also look to outputs (i.e., student scores, job opportunities, etc.). Equity for tax payers can measure tax burdens or taxes paid for benefits received. Equity for school districts can look to relative property wealth, relative tax rates, relative ability to purchase services.

Tax and Revenue Freeze: Constitutional or legislative enactments which place limits on the rate of taxation, the level of assessments or the amount of total revenue which may be directed to education.

III. Summary of Major Findings, Conclusions and Recommendations

A. Chapter 2: Application Approval Priorities

1. Major Issues

We identified four major issues raised by the application approval priorities and their Federal legal framework:

(1) What is the meaning of the provision relating to "economically depressed areas" (EDA);

(2) What is the meaning of the term "new programs";

(3) What does it mean to "give priority" to these factors; and

(4) How do these application approval criteria relate to the other priority requirements applicable to specific programs and permitted uses?

The remainder of this section describes our major findings, conclusions and recommendations applicable to each.

2. The Meaning of the "Economically Depressed Area" Provision

a. Major findings and conclusions -- The VEA requires priority to be given to applicants which "are located in economically depressed areas and areas with high rates of unemployment, and are unable to provide the resources necessary to meet the vocational education needs of those areas without Federal assistance."

We found the meaning of the economically depressed area factor to be unclear. Although this factor is commonly referred to as the "economically depressed area" or "EDA factor" the statute sets out three components: economically depressed area, high unemployment, and inability to meet vocational education needs without Federal assistance. This EDA factor could be viewed as three separate and distinct measures (unemployment rates, location in a geographic area designated as economically depressed, and below average revenues for vocational education), any one of which being a sufficient basis on which to receive priority. It is also capable of being understood as a single measure in which all three factors must be satisfied to receive priority. ED's use of the statutory conjunctive "and" between these terms at one place in the 1977 regulation and "which" in another section did not clarify this definition, but rather created a third option which consists of two alternative measures: (1) economically depressed areas which are unable to provide the resources necessary and (2) areas with high unemployment which are unable to provide the resources necessary.

ED's application of the EDA factor to the states has been inconsistent. Some states have been permitted to use unemployment rates (only one of the three EDA measures) to satisfy the statute, whereas others have been required to combine at least two of the three measures. None of the states we researched understood the meaning of the third component of the EDA factor "unable to meet the vocational education needs without Federal assistance," therefore, none used it.

The EDA priority is also unclear because neither the statute nor ED has ever clarified what is meant by the term "area". Area could be a subpart within a recipient's geographic border (i.e., a neighborhood with high unemployment), a portion of the state or a region of the country. Most of the EDA measures used by states to determine the "priority" a specific recipient's application should receive, do so for areas which are larger than the geographic area for a single recipient. One state uses an EDA measure created by the Department of Commerce which qualifies 95% of the districts in the state as economically depressed. The measure does not significantly distinguish among applicants on the basis of need for vocational education or ability to pay and ED's proscription against EDA measures which result in a "yes" or "no" designation did not resolve these problems.

b. Major recommendations -- We recommend that Congress eliminate the EDA priority factor as currently constituted. We suggest that if Congress wants to interrelate vocational education and economic or labor market disparaties, it adopt other specific mechanisms for ensuring the responsiveness of vocational education to areas experiencing economic problems. It is clear that inclusion of a measure of EDA as a factor in a funding formula is not an adequate mechanism for satisfying this congressional objective so long as the measures of EDA are for areas which are larger than single recipients. Further, we recommend that the Department of Commerce concept of economically depressed areas not be used as a factor for prioritizing or approving recipient applications. This measure identifies the majority of recipients as economically depressed in many states and fails to distinguish among recipients that by any reasonable standard are very different in terms of economic depression and fiscal ability. Unemployment data, although more up-to-date, also presents inadequate information on which to base funding decisions. These data are usually not specific to the recipient's area, and therefore treat recipients with differing economic health the same. Such an inexact measure should not be part of a legal framework for distributing funds among recipients.

3. The Meaning of "New Programs"

a. Major findings and conclusions -- The second issue concerns the meaning of "new programs." The VEA requires states to give priority to applicants which "propose programs which are new to the area to be served and which are designed to meet new and emerging manpower needs and job opportunities in the area and, where relevant, in the States and the Nation." We found the term to be conceptually vague and that the legal framework added to the confusion rather than clarified its meaning.

On one level, "new programs" is a simple concept: an applicant proposing a program which it has not previously offered is clearly new. "New" can also mean innovative approaches, new curricula or restructured programs. Rather than narrowing the concept, ED added to it the notion of expansion, thereby enlarging it to respond to the goal stated in the Act of meeting "new and emerging manpower needs and job opportunities." Some states use this expansion component to justify funding new and replacing obsolete equipment (in an existing program), or to expand an existing program to accommodate a larger number of students. Other states, concerned with the legality of such a broad definition, limited the term to absolutely new, first time programs.

ED has left the precise definition of new programs to the states, and limited its guidance to describing alternative measurements. ED subsequently added a third option which was to measure new programs by the actual number of new programs proposed by an applicant -- despite the likelihood that this disadvantages small and fiscally disabled applicants the VEA was intended to benefit.

ED's guidance as to the definition of new programs has been inadequate to help states counter possible abuses in applicant identification of "new" programs. States without authority to approve and disapprove vocational education programs in LEA's and OER's indicated they had to rely on an applicant's designation of a program as a new, and had no check on non-duplication or identification of new programs. States with such authority under state law still encounter problems with duplication and abuse in labelling programs as new.

Finally, ED has not offered any interpretational guidance with respect to the duration of new program funding. Even though a multi-year grant would be more beneficial to the poorer recipients and enable them to absorb the on-going costs after the start-up period of a new program, most states do not make multi-year grants for fear of violating the funding requirements and incurring an audit exception.

b. Major recommendations -- If Congress intends VEA funds to be used to develop new vocational education programs, we recommend that it clarify the term "new." Although Congress may want to adopt ED's interpretation, which includes new and expanding programs, we recommend that it adopt a legislative definition to specify whether new or modified equipment and facilities are included in the definition. We make no recommendation as to precise definitions because the options vary with policy objectives sought. If Congress retains the new program priority we recommend it permit programs to be considered new for 3 to 5 years to permit a gradual phase-out of new program funding.

4. The Meaning of "Give Priority"

a. Major findings and conclusions -- We found these application approval criteria to be inadequate because they fail to describe how a state is to give priority to applicants proposing new programs or applicants located in EDAs. The statute does not indicate what mechanisms are to be used to give priority. Assuming a variety of mechanisms can be used, ranging from funding pools to a one-step formula factor, it does not indicate how priority is to be given under these different mechanisms. And it leaves unanswered the key issue of how much priority must be given to applicants with priority needs or uses.

ED has not addressed any of these issues in a clear, consistent or comprehensive manner. ED's interpretations have focused almost exclusively on (1) distinguishing between giving priority under so-called "one-step" or "two-step" processes, and (2) specifying how application approval factors should function as factors in a formula.

Unfortunately this one-step/two-step dichotomy failed to take into account the key elements of the application approval and fund distribution methods actually used by states for VEA funds, thereby ignoring significant differences among various methods. One general method of allocating VEA funds is by applicant entitlement generated by a formula where all approved applicants receive varying proportions of the state VEA allocation. Another is the project application method where applications are ranked and often fully funded in rank order based on the amount sought in the application.

ED's policy guidelines do not recognize the differences between these methods and consequently ignore how priorities can be given under a project approach, or imply that they cannot be met using this method. This has been a critical omission since many states use the project method of funding for at least some VEA purposes.

Although ED has approved the project method of funding, its failure to clarify how priority factors (and fund distribution factors) can be used under the project method has permitted states to incorporate these priority considerations in the project method in such a way that they have virtually no effect on the allocation of VEA funds. This occurs, for example, when a state uses these priority considerations to rank applicants to establish priority for funding, but where the amount of funds designated for that project statewide is sufficient to fund all applicants. In this case all applicants receive all the funds they apply for and the ranking is simply an academic exercise. Such processes of manipulation have been ignored by ED.

We found ED's interpretation that states must give priority to EDA and new program factors by assigning them a numerical function and including these measures as variables in a one-step or a two-step funding formula to be an inadequate way "to give priority." These factors are inappropriate for inclusion in any mathematically scaled funding formula because they identify qualities that are inappropriate for quantifying on a continuous scale. They are particularly inappropriate to include in one of ED's "one-step" formulas with the more precise, scaleable funds distribution factors.

In contrast, we found funding pools, such as are used in several states for new programs, to be an effective method of giving priority in application approval. ED, however, has not provided guidance on the use of funding pools for prioritizing purposes. States were unsure how pools used for one priority related to the other application approval priority or to the funds distribution factors. These issues will be analyzed in greater detail in section IV of this chapter.

b. Major recommendations -- We recommend that Congress clarify the meaning of giving priority to applicants by specifying the options available to states.

Specifically, Congress should consider requiring that states either (1) establish funding pools for each priority (*i.e.*, separate pots of money to which recipients submit separate applications for such funds); or (2) require recipients to set a specified amount of funds aside for each priority as a condition to receiving general VEA funds (*i.e.*, set-asides).

5. Other Priority Factors

a. Major findings and conclusions -- We found the terms "dropout" and "youth unemployment," which are the basis for the additional priorities for certain of the subpart 2 uses (*i.e.*, work-study and cooperative education) and subpart 4 special programs for the disadvantaged, to be conceptually clear. However, states experienced difficulty *applying* the concept of youth unemployment because data on youth unemployment, like adult unemployment, is reported for areas broader than most recipients. ED has given no guidance on how to deal with measures that are not recipient specific, *e.g.*, use of proxies or proration, and states experience difficulty combining such measures with recipient-specific measures.

We also found the legal framework to be unclear about how these additional priority factors relate to the two application approval priority factors or to the funding formula requirement. ED did not provide clear and consistent guidance as to how application approval priorities and these additional priorities are to be combined. For instance, states were not sure whether the EDA factor for consumer and homemaking (subpart 5) was the same as the application approval priority, nor how they related. Nor was it clear whether the youth unemployment concept applicable to work-study, cooperative education and subpart 4 was to substitute for, or was in addition to, the application approval priority factors.

In the context of the general application priority and fund distribution provisions of the VEA, these additional priorities for work-study, cooperative education, and subparts 4 and 5, add a level of complexity that appears unwarranted particularly since the general fund distribution factor for low-income persons is probably a reasonable proxy for youth unemployment and school dropouts, and the economically depressed area priority for consumer and homemaking education is also applicable to the whole of the VEA. Consequently, we see little to be gained by continuing these separate priorities.

b. Major recommendations -- If Congress, however, intends separate or additional priorities to be given effect, it should clarify the mechanisms to be used to give the additional priorities. We have concluded that including these as additional factors in a formula fails to give these much additional priority and dilutes the impact of the other fund distribution factors. We suggest that Congress adopt a prioritizing mechanism which parallels the mechanism we have recommended for the application approval priority, i.e., the use of set-asides and funding pools, which would ensure that a certain portion of VEA funds would be applied to each priority use and distributed on the basis of a limited number of factors.

With respect to the minimum percentage expenditure (33%) of the subpart 5 funds consumer and homemaking funds in economically depressed areas, we have concluded that the priority accomplishes little. Under every EDA measure created for the application approval priority which we examined, more than thirty-three percent of the recipients qualified as economically depressed areas and received priority treatment. This means that the consumer and homemaking funds can be and are distributed without concern for targeting on any special areas. Congress must either designate a measure which would identify fewer than the minimum percentage, or increase the percentage to ensure that the priority has any meaning.

We also recommend that Congress not require states to use area concepts, such as youth unemployment, to prioritize applicants for work-study, cooperative education, and subparts 4 and 5. Rather, we recommend that all priority measures be recipient-specific, such as youth dropout.

B. Chapter 3: Funds Distribution Factors

1. Major Issues

Section 106(a)(5)(B)(i) of the VEA specifies the "two most important factors" which states are to use to determine the distribution of VEA funds to local education agencies (LEAs) and other eligible recipients (OERs). For LEAs, the two most important factors are: (1) "relative financial ability of such agencies to meet the need for vocational education in the areas they service" and (2) "the relative number or concentration of low-income families or individuals within such agencies." For OERs the two most important factors are: (1) "the relative financial ability of such recipients to provide the resources necessary to initiate or maintain vocational education programs to meet the needs of their students," and (2) "the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language."

We have identified three issues raised by the fund distribution factors provision:

- Whether "local education agency" and "other eligible recipient" are sufficiently clear and appropriate categories of recipients for making distinctions in the distribution of VEA funds.
- Whether the measures of relative financial ability are sufficiently clear and comprehensive to identify the most needy LEAs and OERs.
- Whether the low-income and higher-cost student measures are adequate to readily identify LEAs and OERs most in need of VEA funds.

2. The Use of LEA and OER as Separate Categories of Recipients for Purposes of Funds Distribution

a. Major findings and conclusions -- There are substantial differences between school districts and post-secondary institutions in legal structures, geographical service patterns, and funding sources. The VEA definitions of LEA and OER, however, do not necessarily coincide with the commonly accepted distinction between school districts, which generally serve students through grade 12, and post-secondary vocational education institutions, which commonly are community colleges and area vocational centers.

The general definition of LEA in the VEA is so broad as to potentially include virtually all public post-secondary institutions, as well as public school districts. In contrast, the different fund distribution requirements of section 106(a) (5)(B)(i), which distinguish between LEAs and OERs, appear responsive to real differences between school districts and post-secondary institutions. But the breadth of the general definition of "LEA" has given states the choice to treat post-secondary institutions as LEAs or as OERs.

Because work-study and cooperative programs funded under the VEA are limited to LEAs, some states have included post-secondary institutions as LEAs to qualify for these programs. We express no opinion on whether these programs should be limited to school districts; however, the pressure to qualify post-secondary institutions for work-study funding has resulted in some states designating post-secondary institutions as LEAs even though the fund distribution factors for OERs are generally more appropriate for the allocation of funds among these post-secondary institutions.

b. Major recommendations -- We recommend that Congress clarify that regardless of whether post-secondary institutions may receive VEA funding for work-study and cooperative education programs, post-secondary institutions should be treated as OERs for purposes of funds distribution.

3. Relative Financial Ability

a. Major issues -- Relative financial ability (RFA) is the concept chosen by Congress to assure that LEAs and OERs with the least fiscal ability within a state receive a greater proportion of VEA funds. The statute does not define "relative financial ability." Definitions of both terms are found in the legislative history. These definitions have not, in all areas, been sufficiently clear or flexible to be applied without interpretation; and ED's interpretations of these terms have been at the same time sketchy, overly rigid and inconsistent.

The primary measure of RFA, local property wealth, has not been adequately defined to effectuate Congress' equalization goal. Federal administrative efforts to create and implement an operational definition of local property wealth have been riddled with inconsistencies. ED has taken a firm position that property wealth is to be measured per capita rather than per student based on the use of the term "per capita" in the legislative history. This rigidity failed to take into account data problems associated with ED's definition and the distortions of actual fiscal disparities its definition has created in some states. There appears to have been little recognition that the measure of relative financial ability needs to be appropriate to the educational finance system of a particular state.

We identified four problems which have been created by this legal framework. First, the definition of RFA as interpreted by ED is overly rigid and inappropriate for use in all states. Second, it does not provide guidance with respect to measures of RFA where local property wealth has little effect on educational revenues and expenditures. Third, it is unclear with respect to the treatment of post-secondary institutions which do not receive local funds. And, fourth, it does not require recipient-specific data for measuring RFA.

b. Property wealth or tax rate definitions

(i) Major findings and conclusions -- ED has been overly rigid in requiring that a per capita measure of local property wealth be used, except when states have been able to convince ED that "exceptional circumstances" for using a per pupil measure were p-esent. This requirement failed to take into account that population data are often outdated and unavailable on school districts. This means the data are old, or the wealth variation is minimized by using data for areas larger than individual LEAs, or both. This has the effect of distorting and minimizing the variation in relative financial ability for which Congress intended VEA funds to compensate. In addition, there are certain differences among states in sources of local revenues for school districts that should be taken into account in designing a measure of relative financial ability. For example, where school districts are partially funded from local income taxes, this local source is a legitimate component of a measure of relative financial ability. Moreover, states have developed their own definitions of relative financial ability for distribution of state aid to school districts. Many state definitions of local wealth take into account personal income available locally to pay property taxes, or take into account higher cost students by weighting the students count used to calculate local wealth per pupil by students requiring higher cost programs.

(ii) Major recommendations -- In our view, states have had substantial experience in the measurement of local financial ability of school districts, and general school aid formulas in most states are substantially equalizing for local financial ability -- as far as these aid formulas go. Consequently, we recommend that states be given the option of using either a per pupil or per capita measure of property wealth for RFA, and that each state be permitted to use the same measure of relative financial ability as it uses in its general school aid formula, if it uses such a measure. This would remove ED from having to develop sufficient knowledge and expertise to determine how to measure this concept in each state.

c. Effect of tax and revenue limitations

(i) Major findings and conclusions -- Another issue which has created problems for the interpretation of "relative financial ability" is how should this be defined when legal constraints are placed on the use of local tax resources. This is a problem that has arisen in recent years as a result of statutory or constitutional limitations being placed on local property tax rates, assessment levels or local revenue increases.

The argument has been made to ED that as a result of such limitations RFA should be ignored in VEA funds distribution. We agree with ED's interpretation that RFA should not be ignored in these situations. Tax limitations affecting local revenues do not necessarily eliminate local fiscal capacity as a determinant of school district expenditures. Tax limitations typically do not place low wealth school districts in a better relative position in comparison to wealthy districts than they were before such limitations; in other words, they generally leave unaffected relative differences among school districts in fiscal capacity. Even tax limitations that totally freeze the local property tax rate or local revenues or assessments do not eliminate the impact of past fiscal disparities on current and future expenditures of school districts. Consequently, tax limitations do not, in and of themselves, eliminate the effects of differing fiscal ability on school districts' expenditures. And, in our opinion, the adoption of a tax limitation provision should not be the basis for dispensing with relative financial ability as a required fund distribution factor.

Another issue raised by tax limitations is whether a measure of RFA other than the local tax base per capita or per pupil of the recipient should be used when local tax revenues for education are constrained. ED, in one state we studied, permitted RFA to be measured by the state and local revenues per pupil of school districts, in lieu of property wealth per pupil, because of a state limitation on the use of the local tax base.

In our view, ED's result was correct but, for the reasons discussed above, this result should not be based on the existence of a tax limitation provision. Rather, such a measure of RFA should be permitted only when local revenues make up a relatively small proportion of total state and local revenues. When only a small share of total school district revenues (minus Federal funds) come from local sources, it is reasonable to use total state-local revenues per pupil as a measure of the relative financial ability of school districts. Since the variation among districts within a state in state-local revenues per pupil is less than the variation in local property wealth per pupil, the major effect of using this alternative measure will be to permit states to distribute

VEA funds more like a flat grant per pupil. This appears reasonable when a state has undertaken to fund a larger proportion of the cost of the public schools.

(ii) Major recommendations -- We recommend that the alternative measure of RFA be permitted for those states in which local revenues make up less than 25% of the total revenues (less Federal funds) of school districts. We recommend that the same standard also be applied to other eligible recipients.

To clarify this we suggest the following definition of "financial ability":

> "The term "financial ability" means the property wealth per capita or per student of local school districts and of other public agencies having a tax base or the total tax effort of the area served by these schools and agencies as that effort is a percentage of the income per capita of those within the taxing body, except that (1) a state may use the same measure of "financial ability" used in the general school aid formula of the state, if the state formula includes such a measure; and (2) in any state in which local revenues constitute less than 25 percentum of the total financial support from state and local sources of all public agencies which are of the same type, the state may define financial ability as the total revenues or expenditures for current operating purposes (less Federal) per capita or per student available to or expended by a public agency.

d. Post-secondary institutions with no local tax base

(i) Major findings and conclusions -- Some post-secondary institutions offering vocational education receive no funds from local tax sources. Their revenues come primarily from state taxes and tuition. ED has struggled, without substantial success, to clarify how RFA should be applied to such institutions. At one point ED permitted states to ignore RFA; subsequently, RFA had to be included using either a composite property wealth measure, which makes little sense; or total state-local revenues, for which calculations were unclear.

(ii) Major recommendations -- We recommend that RFA be retained for post-secondary institutions, including those receiving little or no local tax revenues, but that the measure of RFA be the institution's total revenues or expenditures for current operating purposes (less Federal funds per capita or per student) where local revenues constitute less than 25 percent of total financial support (less Federal) as set out in the LEA recommendations. This will help to ensure that the equalization objective of the 1976 amendment is carried out at the post-secondary level.

e. Recipient-specific data

(i) Major findings and conclusions -- ED required some states to use a "per capita" rather than a "per pupil" measure of local property wealth, even when per capita data were not available for individual recipients. This distorted and underestimated actual differences among recipients in relative financial ability.

(ii) Major recommendations -- As described earlier we recommend that states be given the options of using either a per capita or per pupil measure of local financial ability, but that the legal framework require the measure to be recipient-specific, whichever measure is used. In other words, the data used to calculate RFA should be for individual LEAs and OERs, not for broader areas. As discussed in Chapter 2 in connection with the EDA factor, measures that are for areas broader than individual recipients mask actual differences among recipients by averaging them.

4. Low-Income Families and Higher Cost Students

a. Major findings and conclusions -- RFA is one of the two most important fund distribution factors for both LEAs and OERs. The other most important factor for LEAs is "low-income families or individuals within such agencies"; and for OERs it is "the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language."

In our opinion, Congress chose wisely when it selected these factors as complements to RFA. Low-income is an accepted measure of the need for additional educational services, and also can be considered a proxy measure for the capacity of the local population to fund education. Title I of the ESEA (now chapter 1 of the Education Consolidation and Improvement

Act of 1981), for example, has long used low-income to target aid to educationally disadvantaged students.

The statutory definition in the VEA of "low-income family or individual" which requires the use of the latest available data from the Department of Commerce is, however, too restrictive to carry out congressional intent. Such low-income data either may not be available on an LEA basis or may be as much as ten years out of date.

We found higher cost students served by OERs to be an appropriate indicator of need for additional VEA funds for OERs. OERs, which are primarily post-secondary institutions, often draw students from an undefined area; and area data on low-income, such as district data which is appropriate for LEAs, could be highly misleading when applied to OERs. Consequently, we conclude that for OERs the student population of the institution whose education imposes higher than average costs is an appropriate measure of the relative need for funds for vocational education.

ED failed to interpret how this fund distribution factor should be measured. This has allowed states to use inaccurate measures or mathematically eliminate the factor while appearing to use it. It also allows OERs to define it to suit their purposes. For example, although the statute refers to "students whom [OERs] serve whose education imposes higher than average costs," ED has not required an assurance or showing that such students receive higher cost programs.

In addition, head counts of students at post-secondary institutions can be very illusive because of the variety of part-time enrollments; yet ED has not interpreted this to require student data that are comparable from institution to institution, *e.g.*, by use of a full-time equivalency measure.

b. Major recommendations -- We recommend that the statute be amended to permit states to use the best, most current, available data for individual LEAs on low-income, including counts of children from low-income families; for example:

- Low-Income Family or Individual

> The term low-income "family or individual" means families, individuals, children or students who are determined to be low-income according to the best, most current, available data specific to an applicant or to the area it serves.

With respect to higher cost students, the variation in the pupil and fund accounting systems of post-secondary institutions precludes us from making a specific recommendation to address the problems we found. Rather, we would recommend that they be further reviewed.

C. Chapter 4: Methods and Mechanisms for Distributing VEA Funds

1. Major Issues

In Chapters 2 and 3 the clarity, consistency and adequacy of the terms describing the application approval priorities and funds distribution factors are analyzed.

Chapter 4 describes and analyzes the methods and mechanisms through which these application approval priorities and funds distribution factors are given effect.

We found the legal framework relating to the methods and mechanisms to raise three major issues:

(1) Is the requirement that a "formula" be used to distribute VEA funds among recipients appropriate and its applicability clear;

(2) Is the legal framework clear, consistent and adequate with respect to the design requirements for this formula; and

(3) How is the formula to be applied to the various uses of VEA funds?

The remainder of this section describes our findings, conclusions and recommendations.

2. Requirement of a Formula

a. Major findings and conclusions -- The VEA itself does not use the term "formula." This term first appeared in the appendix accompanying the final regulations issued in 1977 in which ED interpreted section 106(a)(5)[1] of the 1976 amendments to require states to use a formula to distribute VEA funds.

ED has interpreted the formula requirement to apply to most VEA funds, including funds carried over from a previous year or reallocated in the same year. The formula is only applicable to the distribution of Federal funds.

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[1] Section 106(a)(5) includes the application approval priority factors, funds distribution factors and prohibitions on the use of certain methods for the distribution of funds and a particular funds distribution outcome.

We found that all the states in our study used formulas to distribute VEA funds to recipients. These formulas used three different methods of distributing funds:

(1) the percentage reimbursement method;

(2) the direct allocation method; and

(3) the project method.

Three of the states use their formulas to determine, for distribution of at least some VEA funds, a variable percentage of a recipient's total cost of vocational education or a percentage of a certain cost, e.g., teachers' salaries, equipment. Where this percentage reimbursement method is used, the percentage of costs remaining after the Federal percentage is calculated must be borne by the recipient from local and state funds. One state that has a specific categorical state aid program for vocational education coordinated some of these with the percentage reimbursement calculation.

The one state that does not use the percentage reimbursement method uses its formula to calculate a direct allocation of VEA funds to each recipient. What percentage this represents of total funds for vocational education, for a vocational education program, or for a particular cost element, is irrelevant to the workings of the formula. Other states in our study also allocate VEA funds for some uses as a precise dollar amount without reference to a percentage reimbursement (in addition to using the percentage reimbursement method for other uses).

Three of the four states used the formula with a project method of funding for at least some programs. In the project method, approved applications are ranked based on fund distribution factors and applicants are funded in the order of the ranking.

In each case, the formulas used were "one-step" formulas, i.e., formulas which combined the two application approval criteria and two funds distribution factors as formula variables.

ED has consistently interpreted the VEA to require states to use a "formula" to distribute VEA funds among applicants approved for funding. It is our conclusion that this interpretation is correct. A formula, properly constructed, is necessary to ensure that the statutory objective of "equalization of educational opportunity," particularly for recipients having below-average financial ability and above-average concentrations of low-income and higher-cost populations, is met.

The formula requirement by itself provides no assurance that the objective will be met. A funding formula is simply a mechanism for distributing funds whose results are based on arithmetically related variables and are both predictable and replicable. Although in this regard a formula is an "objective" mechanism for distributing funds, the mere existence of a formula does not preordain any particular result. The outcome of a formula is determined by such things as (1) the variables used in the formula; (2) how they interact in the formula; (3) how factors are scaled and interrelated; and (4) how formula scales relate to variation in amounts of VEA funds.

b. Major recommendations -- The requirement that there be a formula for distribution of VEA funds is the foundation for considering issues related to an equitable and educationally sensible distribution. The formula requirement is the core of a principled and consistent funds distribution system. We recommend that it be retained as the funds distribution mechanism.

3. General Formula Design Requirements

a. General findings and conclusions -- The statute specifies that the criteria set out in subsection 106(a)(5)(A) are to be used to give priority to applicants "in considering the approval of such applications" (application approval priorities). The "factors" for LEAs and OERs specified in subsection 106(a)(5)(B)(i) are to be used as the basis for "determining the amount of funds available" to "applicants approved for funding" (fund distribution factors).

ED has interpreted the VEA as giving states the option of using two different mechanisms for relating the application approval priorities and fund distribution factors. It has termed these two mechanisms the "two-step" process and the "one-step" process.

In a two-step process, the first step is approval of applicants and the second is funds distribution to approved applicants. In the first step, applicants are ranked according to the application approval factors (EDA and new programs) and "a cut-off point is established beyond which no recipient is funded." In the second step, the amount of VEA funds received by applicants approved for funding is determined by applying the funds distribution factors (relative financial ability and low-income persons/higher-cost students).

In the one-step process, the two application approval priority criteria and the two fund distribution factors are combined into a single formula which is used to rank applicants and allocate VEA funds based on each recipient's total score from the combination of these factors.

As noted above, the statute requires the fund distribution factors of RFA and low-income persons/higher cost students to be the "two most important" in determining the distribution of VEA funds. ED has interpreted this to mean that in a one-step process these funds distribution factors must individually receive the greatest weight in the process, and the application priority factors must individually be given lesser weight.

The statute requires that VEA funding be based on "economic, social and demographic factors relating to the need for vocational education among the various populations and the various areas of the State...." Other than the two most important fund distribution factors and the application priority factors (included by ED interpretation), there has been no written interpretation concerning the number or types of additional factors that can be included in a VEA formula. ED, however, appears to have sought, in dealing with individual states, to discourage the use of additional factors.

The statute prohibits two methods of funding and one distributional outcome. Section 106(a)(5)(B)(ii). First, the statute prohibits states from allocating VEA funds "among eligible recipients within the state on the basis of per capita enrollment." Second, it prohibits allocating VEA funds "through matching of local expenditures on a uniform percentage basis." Third, the statute prohibits a state from denying VEA funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."

In general, we have found that the Federal legal framework has been unclear concerning basic formula design requirements and that some of ED's interpretations concerning the design of formulas have been inconsistent with the congressional objectives that VEA funds distribution requirements were intended to further. In addition, the statute and ED's interpretations do not establish a legal framework sufficient to address all of the issues that are essential for designing a VEA funds distribution formula.

Specifically, we identified four components of a formula which require a greater clarity and precision in order to effectuate Congress' clear intentions:

(1) The number and types of formula factors;

(2) The scales of formula factors;

(3) The relationship of the factors to each other so that some are given greater important than others; and

(4) The use of scales to determine VEA funding amounts.

As analyzed in this chapter, we found the framework for designing formulas to have been made needlessly complex. We make specific recommendations which are intended both to simplify the legal structure and ensure that VEA formulas carry out the objectives Congress intended, while at the same time affording states substantial flexibility in addressing particular vocational educational needs.

b. The numbers and types of formula factors

i. The inclusion of the two application approval priorities as formula factors -- As described above and in Chapter 2, ED has interpreted the VEA to require that a state's VEA formula contain both the application approval priorities (new programs and EDA) and the two required fund distribution factors (RFA and low-income/higher cost students) if the states a so-called "one-step" formula. In Chapter 2 we concluded that inclusion of the two application approval criteria as formula factors did not give them the priority Congress intended.

Their inclusion also has a reciprocal effect on the required fund distribution factors: it tends to dilute and confuse the effect of the required fund distribution factors. This dilution is of particular significance because as discussed in Chapter 2, the application approval criteria of new programs and economically depressed areas are not appropriate concepts for determining the amount of funds recipients should receive and/or lack appropriate recipient specific measures. Not only does their use as fund distribution factors dilute the other appropriate factors, but it also makes it virtually impossible to predict the distributional effects of VEA funding formulas. As considered in Chapter 3, we have concluded that the RFA and the low-income persons/higher cost student factors, if properly measured, are appropriate for carrying out congressional intent in the distribution of VEA funds. The application approval criteria, when turned into funding factors, are not.

In contrast, we agree with ED's interpretation of how the two required fund distribution factors should operate in a two-step process. In a two-step process, application approval priorities are used to select applicants for funding (step 1) and then the two funds distribution factors are used in a formula to determine the amounts approved applicants will receive (step 2).

In this case the formula is not confused by inclusion of application approval criteria.

Consequently, we recommend that Congress clarify that the application approval priorities of section 106(a)(5)(A) may not be used as fund distribution factors.

ii. The inclusion of additional formula factors -- At present, the VEA does not explicitly limit the number of factors that can be included in a formula so long as they are "economic, social (or) demographic." As described in the Federal legal framework, ED's Task Force Report stated that some states had created extemely complex formulas, with eight, ten, or more factors, with some factors using multiple indicators. ED has informally discouraged the use of any additional factors in a formula. We agree with ED's objection to the inclusion of factors in addition to those specified in the statute. The addition of factors is a major way that a formula can be manipulated to defeat intended distributional objectives.

We recommend that-VEA formula factors be limited to the two required by statute: for LEAs, RFA and low-income persons; for OERs, RFA and higher cost students. The use of only two factors will ensure the funding focus Congress has long intended, and will also make formulas simpler and more predictable in effect.

This recommendation will not decrease state flexibility in the use of funds; indeed in conjunction with other recommendations, states will have greater flexibility. This recommendation must be read in conjunction with other recommendations contained in this report, _i.e._, that states be permitted to use measures of the RFA factor that they use in their own general aid to education formulas (see Chapter 3); and that states be permitted to override the allocation determined by formula based upon other objective criteria of relative recipient need for vocational educational services, equipment or facilities (discussed later in this chapter).

iii. _The proper inclusion of a factor for the size of recipient vocational educational programs_ -- The VEA prohibits states from allocating VEA funds "among eligible recipients within the state on the basis of per capita enrollment." We found that, in some states, ED represented that this precluded the use of pupil multipliers or large additive factors; whereas in others, these per pupil factors were permitted.

It has not been clear under the VEA legal framework how the size or potential size of a recipient's vocational educational program could be taken into account without violating this prohibition. We conclude that there is no conflict between the "per capita" distribution prohibition and the appropriate use of factors representing the size of recipient's programs, _e.g._, vocational enrollments. We recommend that Congress clarify that there is no conflict between them. We further recommend that in applying the fund distribution factors, states be required to take into account the size or potential size of a recipient's vocational educational program.

c. The proper scaling of factors

i. Major finding and conclusion -- One of the first issues states have had to resolve in structuring their VEA formulas is how to scale the factors, that is how to convert the raw numbers of each factor into a numerical value which can be used (1) to compare applicants on that factor and (2) to combine with other factors in the formula.

ED has not developed guidelines with respect to scaling. As a result, states are free to use either of two methods of scaling: continuous and discontinuous. Continuous scaling converts the raw numbers into a different expression of its value but retains the actual range of variance between factors. Discontinuous scaling converts raw numbers into a different expression of its value which does not retain the actual range of variance between factors.

We concluded that the use of discontinuous scales distorts the actual variation of factors among applicants.

ii. Major recommendations -- We recommend that if Congress continues to be concerned with equalization as reflected in funds distribution factors, it should add a provision to the VEA that puts parameters on how these factors are scaled.

First, we recommend that continuous scales be required. Second, we recommend that parameters be placed on factor scales to ensure that there is a substantial correspondence between the ratio of variation of each fund distribution factor and the ratio of variation of the numbers used to scale each factor.

We specifically recommend that a scale parameter be based on the ratio of variation in the unscaled fund distribution factors (RFA, low-income and higher cost students). Other parameters could be selected which would ensure substantial, although not complete, proportionality between factors and scale variation. For example proportionality could be required based on the full range or selected percentile range of variation up to a specified maximum ratio.

In many formulas the points for each factor are combined to obtain a point total for each recipient and for all recipients in the state. We have recommended above that formulas contain only the two required fund distribution factors. In combining the points from the scales for these two factors, we recommend that parameters similar to those for the individual factor scales operate to govern their combination. A parameter on factor combination is needed because the simple addition of a constant value to the factor totals can render the individual factors largely irrelevant. Consequently, we recommend that Congress add a parameter on the ratio of factor difference when both fund distribution factors are combined. A possible parameter is that the ratio of lowest to highest possible combined factor score be, at a minimum, not less than the average ratio of the individual factor ratios.

d. Relating the factors to each other so that some are given greater importance than others

i. Major findings and conclusions -- As described in the legal framework, ED has determined that the two funds distribution factors must receive greater weight than any other formula factors.

We found that in reponse states have developed different systems of weighting formula factors, i.e., multiplying a formula factor by a whole number or a fraction to adjust the relative effect of that factor in the formula. When numerous factors are included in the formula, the weighting can operate to decrease the importance of the "two most important factors" even though they receive more weight than other factors.

ii. Major recommendations -- The problems of relating factors to each other and of determining their relative importance have arisen largely from the inappropriate inclusion of application approval priority factors in the formula and the lack of limitation on the number of factors. Dealing with these problems as we recommend will eliminate most problems concerning the relative weight to give specific factors. However, if Congress continues to permit additional factors, the weighting problem would be addressed, in part, by the ratio parameters for the formula factors as described in the preceding section.

e. The use of scales to determine VEA funding amounts

i. Major findings and conclusions -- As described in subsection (c) above, states must decide how to scale each formula factor to account for the variations among recipients. In addition, decisions must be made about how to convert each recipient's total score into the amount of funds each recipient will receive.

We found that the use of scales or other calculations to determine the amounts of VEA funding each eligible recipient will receive, after fund distribution factor amounts have been calculated and compared, can be the most important step in a formula. Inappropriate decisions made at this stage can destroy the effects of a fund distribution formula that would otherwise appear exemplary. Although the VEA contains prohibitions on per capita distributions and uniform percentage matching, these issues have been largely ignored by ED's interpretations. We also found that in some states formulas had been designed, intentionally or unintentionally, in a way that circumvented these objectives and, in operation, would of mathematical necessity tend to allocate VEA funds in a manner that is close to a flat grant or uniform reimbursement.

We noted fewer problems in this regard in formulas that directly allocate VEA funds to recipients, i.e., those that do not use a variable reimbursement percentage or local match. The major problems of these direct allocation formulas appeared to be in the selection and definition of factors and factor scaling. Once the factor totals for these formulas were calculated, the amounts of VEA funds allocated tended to be proportional to these totals. This is not, however, inherent in direct allocation formulas. If opportunities for reducing the degree of variation through formula selection and scaling are closed off, some states may seek to create scales that reduce the proportionality of factor totals to fund allocations. Thus, the recommendations that follow apply to both percentage reimbursements and direct allocations.

ii. Major recommendations -- It is our conclusion that if Congress intends that VEA funds be used to equalize for differences in RFA and low-income/higher cost students among recipients, the VEA must be clarified to give greater precision to the VEA requirements prohibiting per capita grants and uniform percentage reimbursements. The methods we recommend to accomplish this relate directly to the manner in which formulas are used to calculate the amounts of VEA funds recipients are to receive.

To ensure that VEA funds are allocated to recipients in proportion to their differences in financial ability and need for vocational services as shown by the RFA and low-income/higher cost student factors, we recommend that ratio parameters be placed on the scales used to allocate VEA funds or if a scale is not used, then on the final allocation of VEA funds.

This ratio would not be calculated on the individual fund distribution factors, but rather would be determined by comparing the formula total of the eligible recipient with the lowest VEA formula calculation to the formula total of the eligible recipient with the highest formula calculation. This ratio of lowest to highest formula totals would establish the minimum ratio of variation for the amounts allocated to the lowest to highest score recipients (in the case of a direct allocation formula) or the lowest to highest percentage reimbursement (in the case of a percentage method).

We also recommend that states be permitted to override the allocation amount determined by the general formula on the basis of (1) objective criteria of specific need for the vocational education that indicate that an eligible recipient has a greater need for the vocational education program or service being funded than would appear from the funding formula calculation, and (2) the agreement of recipients to use VEA funds to meet those needs.

4. Applying the General Formula Requirements to the Various Uses of VEA Funds

a. Legal framework -- The VEA has two kinds of uses: required and permitted. Required uses, in turn, are of two types. One type of required use results from Congress establishing a separate authorization or appropriation for a particular purpose, e.g., Subpart 4 (Special Programs for the Disadvantaged), Subpart 5 (Consumer and Homemaking Education). The other type of required use results from Congress specifying that a certain percentage of a state's allotment must be used for a particular purpose, e.g., of subpart 2 and 3 funds, the state must use 10% for handicapped and 20% for disadvantaged persons. These percentage requirements are commonly called "set-asides."

There are also two types of permissive uses that are relevant to funds distribution issues. The first type requires that states must use priorities in addition to those specified for other VEA funds in allocating funds for these uses. For example, the section 121 work-study and the section 122 cooperative vocational education programs require a preference or priority be given for the factors of school dropouts and youth unemployment. These are considered permissive uses because the VEA does not require states to use their VEA funds for these purposes. The second type of permissive use is distinguishable from the first by not being subject to any fund distribution priorities or factors in addition to the general requirements of Section 106(a)(5). Most of the uses of Subpart 2 Basic Grant Funds, other than work-study and cooperative education programs, are in this category.

We found that states used a variety of methods and mechanisms to distribute VEA funds among the various permitted and required uses of VEA funds. We identified two mechanisms (funding pools and set-asides) and one method (the project method) which states use to direct VEA funds to particular uses.

b. Funding pools and set-asides

i. Major findings and conclusions -- Funding pools are separate portions of the total fund of money for which applicants separately apply. Most of the states in our sample use these to encourage recipients to use VEA funds for a particular purpose.

Set-asides serve a similar purpose. A set-aside is a specified portion of the total amount of funds that an applicant must agree to use for a certain purpose or in a certain manner. Unlike the funding pool, a set-aside is mandatory, *i.e.*, in order to receive any of the total funds, the applicant must agree to spend a specified portion in a certain way.

We conclude that these mechanisms are important for carrying out Federal and state policies. Despite their importance to implementation of the various objectives of the VEA, ED has not provided clear, consistent or adequate guidance.

ii. Major recommendations -- We recommend that the use of funding pools and set-asides in the VEA be clarified. Of particular importance is the need to clarify that the application approval priorities can be met only by establishing funding pools or set-asides which designate a specific amount of funds for these priorities and cannot be met by including them as factors in a formula.

c. The project method of funding

i. Major findings and conclusions -- The project method of funding is typically used to allocate VEA funds to particular uses.[2]

Under the project method, recipients typically propose their own funding levels and the VEA fund distribution factors are used to rank applicants for funding. Generally, applicants are funded in the order of their rank, and the amount of VEA funds they receive is the amount necessary to fully fund their approved applications. Often a variable local match is deducted. This local match is calculated based on the same formula used to rank applicants. Applicants below the point on the rank at which available funds run out receive no funds.

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[2] Section III of Chapter 3 focuses on the other two methods of distributing funds: the direct allocation method and the percentage reimbursement method. The direct allocation method calculates a specific amount of VEA funds an applican is eligible to receive. In contrast, the percentage reimbursement method determines a variable percentage of specified vocational education costs which Federal funds (or the local match) will pay for.

Although the majority of states we reviewed use the project method for funding some VEA purposes, the legal framework does not clarify how the fund distribution provisions apply to projects. It is clear that they apply from both the legislative history and ED interpretation. We identified two problems which require further clarification. First, it is not clear how states are to apply the distribution factors in a meaningful fashion if all applicants are to be funded under the project. Second, although a variable percentage reimbursement is often used in project funding, ED has not required more than an inconsequential variation among recipients.

ii. Major recommendations -- We recommend several alternative parameters on the use of the project method which will remedy the problem of states not applying the funds distribution factors in a meaningful way.

The first alternative for ensuring that states use the fund distribution factors in project funding is to require a cut-off at a specific point on the ranking of potential applicants, such as the state average score in VEA funds distribution factors.

A second alternative would be to use the VEA funds to establish a planning entitlement for each potential applicant, which is the basis for applicants submitting project proposals to the state.[3]

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[3] We also recommend that if either of these alternatives are adopted, Congress also require states to report the ranking used for project funding and show on that ranking where the funding cut-off was made.

In addition, we recommend that the formula override provisions recommended for the direct allocation and percentage reimbursement methods of funding also apply as exceptions to the above parameters on project funding. This provision permits states to override the application approval cut-off or the variable allocation for projects based on objective criteria of specific need for vocational education.[4]

The second problem, which is the inconsequential variation in percentage reimbursements under some of the projects we reviewed, would be remedied by our recommendation that a ratio parameter be placed on percentage reimbursements. As described earlier, the ratio parameter would require that the variation in VEA percentage reimbursements among recipients not be less than the ratio differences in recipients' total factor scores.

D. Chapter 5: Other Fiscal Requirements

1. Major Issues

We identified three additional fiscal requirements which affect the distribution of VEA funds.

(1) the requirements that states ensure that Federal VEA funds are matched with non-Federal funds;

(2) the requirements that states and recipients maintain their level of expenditures for vocational education from non-Federal sources; and

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[4] This override provision also encourages states to expand access to vocational education and gives them greater flexibility in meeting their particular needs in vocational education.

(3) the requirement that states assure that Federal funds are used to supplement not supplant state and local funds that would otherwise be available for vocational education.

These requirements differ from the application approval and funds distribution requirements discussed in chapters 2 through 4 of this part in that they do not direct the distribution of the Federal grant. Rather, these provisions impose limited requirements on how states and local recipients of VEA funds must account for and use non-Federal funds. Although not directly relating to VEA funds, these provisions, and their implementation by states, can have a substantial affect on the distribution of VEA funds to recipients and on the total allocation of vocational education programs throughout a state. This chapter therefore focuses on these affects.

The remainder of this section describes our major findings, conclusions and recommendations applicable to each.

2. The VEA Matching Requirements

a. Major findings and conclusions -- The VEA contains five provisions which require states to match the Federal VEA allocation. Three of those provisions are analyzed in this chapter:[5]

- a dollar-for-dollar match of the total state VEA allocation for the basic and program improvement grants (subparts 2 and 3);

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[5] The other matching requirements are discussed in different chapters. The match applicable to the national priority programs is discussed in chapter 8. The match applicable to the subpart 5 consumer and homemaking education programs is discussed in chapter 2.

- a variable matching amount for a recipient's cost of supervision and administration of vocational education programs; and
- a phased-in dollar-for-dollar match of state administration expenses.

States are permitted to pass these matching requirements on to the recipients or to meet the match at the state level with non-Federal funds.

In general, we conclude that the matching of subparts 2 and 3 funds is not an essential feature of the VEA legal framework. Indeed because of the interpretation which permits states to impose the aggregate state-level match requirement on recipients, this requirement operates to defeat other important congressional objectives, such as assisting low-wealth districts provide quality vocational education programs and ensuring that new programs are provided by recipients having the greatest need for them.

In contrast we found the other two matching requirements, the match for Federal funds spent for state level administrative purposes and local administrative and supervisory purposes, operate so as to ensure a limited Federal role in state and local administration.

b. Major recommendations -- With respect to the dollar-for-dollar state-wide match of VEA funds under subparts 2 and 3 we recommend that this requirement be eliminated from the VEA. We offer no recommendations concerning the matching of Federal funds used for administrative purposes, but merely describe state officials' general observations that these requirements help to ensure that state and local officials and legislative bodies have a stake in the Federal vocational education program.

3. The VEA Maintenance of Effort Requirements

a. Major findings and conclusions -- The VEA contains several maintenance of effort requirements: (1) states, LEAs and post-secondary institutions must maintain either the combined fiscal effort per student or the aggregate expenditure for vocational education from the preceding fiscal year; and (2) LEAs using VEA funds for work-study programs must maintain the level of the expenditures for work-study at not less than the average level of three preceding fiscal years.

With respect to the maintenance of effort requirements (applicable to the state, LEAs and post-secondary institutions and applicable to LEA work-study programs), we found only the recipient-level maintenance of effort provision to be necessary.

We found that the state-level maintenance of effort requirement serves no useful function under the VEA because this requirement is met simply by aggregating the vocational education expenditures from non-Federal sources made by recipients and had no effect on state policy respecting vocational education. A requirement that the state, in addition to the recipient, ensure that the level of vocational education expenditures is maintained is duplicative and meaningless.

The separate maintenance of effort requirement is an inappropriate requirement to be applied to an optional program use such as work-study because it operates as a disincentive to direct funds to that use. States and recipients are reluctant to describe work-study programs in state plans and reports or use VEA funds for them since this results in being bound not to decrease previous work-study expenditures.

In contrast, we found the recipient (i.e., LEA and post-secondary) maintenance of effort requirement to be clear and appropriate. It is at the recipient level that a maintenance of effort requirement is essential in order to assure that VEA funds do not simply replace previously provided state and local funds for vocational education.

b. Major recommendations -- We recommend that the VEA be amended to eliminate the state-level and work-study maintenance of effort requirements. We recommend that the recipient level maintenance of effort provision be maintained with two points of clarification: (1) that the state is a recipient with respect to the funds it applies to state-level vocational education programs and (2) that a recipient unable to sustain a previous fiscal level because of replacement of higher paid staff with lesser paid staff is not in violation of this provision.

4. The Non-Supplanting Requirement

a. Major findings and conclusions -- The VEA requires that Federal funds be used to supplement and not supplant state and local funds that would, in the absence of Federal funds, be made available for the "uses" specified in the Act.

We found this statutory language to be vague, and inadequate to perform its needed function in the Federal legal framework. This requirement has been appropriately interpreted by ED to apply to distributions of state funds for vocational education that take into account the distribution of VEA funds among recipients, however this interpretation has not been disseminated.

We found the nonsupplanting provision to be inappropriate at the local level. Because of recipient discretion to propose a variety of uses of VEA funds, and the VEA's priority for new programs, it would not be appropriate for the nonsupplanting provision to prevent recipients from terminating old programs, so long as overall effort for vocational education is maintained.

b. Major recommendations -- We recommend that the statute be amended to reflect ED's appropriate interepretation of the supplement, not supplant requirement.

CHAPTER 2

APPLICATION APPROVAL PRIORITIES

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Chapter 2

APPLICATION APPROVAL PRIORITIES

I. Introduction

A. Purpose and Organization of this Chapter

The VEA includes two primary provisions that govern the allocation of funds by the state to eligible recipients; namely, the "application approval priorities" provision and the "fund distribution" provision. This chapter analyzes the "application approval priorities" provision. Subsequent chapters analyze the fund distribution provision[1] and the interrelationship between the application approval priorities and fund distribution provisions.[2]

This chapter is divided into five sections. Section I is the introduction, which includes an overview of the Federal legal framework and major findings, conclusions and recommendations. Section II analyzes the first of the two application approval priorities; namely "the economically depressed area" priority. Section III analyzes the second priority, *i.e.*, the "new program" priority. The final section analyzes the relationship between the application approval priorities and other "priority" requirements.

B. Overview of the Federal Legal Framework

The VEA requires states to approve projects for VEA funding on the basis of applications submitted by eligible recipients. The application must: (1) be annual; (2) be developed in consultation with representatives of area education and training resources and the local advisory council; (3) describe the needs for vocational education and how previous evaluation results have affected the proposed program; (4) describe the relationship between CETA manpower programs and proposed program activities; and (5) describe how locally and state-funded vocational education programs relate to the applicant's proposal.[3]

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[1] *See* Chapter 3.
[2] *See* Chapter 4.

The Federal framework prescribes application review standards in the form of two criteria which states must use to give priority "in considering the approval of such applications.[4] The two criteria to be used in prioritizing applicants are:

> (1) whether the applicant is located in an economically depressed area and an area with a high rate of unemployment and is unable to meet the vocational education needs without Federal assistance (EDA factor), and
>
> (2) whether the applicant is proposing programs new to the area to be served, designed to meet new and emerging manpower needs and job opportunities in the area (and, where relevant, in the State and Nation)(new programs factor).

These application approval priorities were added in 1976 as part of the congressional attempt to provide greater specificity to the VEA funding requirements. The Senate proposed both of these priority factors with the expectation that they would assist states to equalize educational opportunity, to focus on high need recipients and programs, and to make hard choices among competing applicants for scarce

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[3] Sec. 106(a)(4) of the VEA (20 U.S.C. 2306(a)(4))

[4] Sec. 106(a)(5) of the VEA (20 U.S.C. 2306(a)(5)(A)).

Federal funds.[5] These application approval priorities of the Senate bill were included in the final bill verbatim.[6]

ED has, through regulations and policy directives, interpreted the meaning of the first application approval factor, economically depressed areas (EDA). In the 1977 regulations ED changed the final conjunctive "and" in the EDA factor to "which" so that the regulation now requires priority to be given to applicants in "economically depressed areas and areas with high rates of unemployment which are unable to provide the resources necessary..."[7] ED sometimes required or encouraged states to use both the unemployment rate and a measure of inability to provide resources for vocational education, for the EDA factor.[8] More recently its interpretation has been that states may use unemployment data as the sole measure of this provision.[9]

With regard to the second priority, new programs, ED has clarified that it "could be similar to other ongoing programs but new to a particular service area or a major expansion of a program to meet unemployment needs."[10] (Emphasis added.)

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[5] S. Rep. No. 94-882 at 70.

[6] H.R. Conf. Rep. No. 94-1701 at 220.

[7] 34 C.F.R. §104.141(f)(5) retains the statutory language but §104.182(c)(1) which describes the requirement for the 5-year plan, uses the "which" construction referred to above.

[8] *See* Final Report DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 4; and DSVPO Program Memo FY 81-5, Feb. 11, 1981 at 4.

[9] DSVPO Program Memorandum FY 81-5, Feb. 11, 1981 at 4.

[10] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 7.

It has also described three alternative "equitable" measures of new programs: (1) the percent of the applicant's budget allocated to new programs; (2) the percent of the applicant's total number of programs which are new; or (3) the actual number of new programs proposed by the applicant.[11] ED has interpreted the statute to preclude it from giving greater clarity to the terms and has required states to develop their own working definitions.[12]

ED has required states to demonstrate in their annual state application how they are including the application approval priorities. ED permits states to use seemingly different mechanisms to include these application approval priorities. For example, ED has permitted states to devise quantitative measures of new programs and economically depressed areas and include them in an arithmetic equation along with the two funds distribution factors ("one-step funding formula method").[13] States may also use the application approval priorities to establish cut-off points for eligibility, applying the funds distribution factors to determine funding amounts ("the two-step formula method").[14] States are not required to use the same prioritizing mechanism for each of the two application approval concepts. For example, ED has permitted states to create new program funding pools or set-asides, while including the economically depressed area priority in a "one-step funding formula."

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[11] DSVPO Program Memorandum FY 81-5, Feb. 11, 1981 at 4. The DSVPO Task Force suggested that the most equitable way to compute new programs was to calculate the dollar amount for new programs as a percentage of the recipient's total annual budget, but accepted the use of the total number of new programs as a percentage of total recipient programs. It believed ED's third method (the number of new programs) was inequitable. Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June, 1979 at 4. ED originally adopted this recommendation. See BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 5; and Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 7.

[12] BOAE/DSVPO Draft Manual for Federal Vocational Education Fund Distribution, Sept. 1979 at 3.

Additional priority factors are also specified in the VEA. If a state decides to distribute its VEA allocation for either work-study or cooperative education programs, which in 1976 were converted from separate categorical programs to permitted optional uses for basic VEA allocations, the VEA requires these funds to be distributed so as to give priority to areas with high school dropouts and youth unemployment. These additional priorities were carried over from the pre-existing legal framework when the VEA was amended in 1976.[15]

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[13] ED has not been either clear or consistent with respect to these new program funding pools. Ed manuals list "new programs" among the examples of optional funding pools, but also require that "they must be distributed through the required fund distribution procedures." OVAE/DSVP Program Memo FY 81-5, Feb. 11, 1981 at 3. Some Federal Administrators have permitted the new program pool to satisfy the priority requirement whereas one required that a state still use a new program measure in the funding formula.

[14] ED issued several policy manuals which indicated that the application approval priority provisions could be incorporated either in a "one-step funding process" (in which the funds distribution and the application approval factors were applied at the same time) or in a "two-step funding process" (in which the application approval factors were used first and then funds distributed on the basis of the two funds distributed factors). See e.g., DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3;and July 1980 at 5-6; OVAE/DSVP Program Memorandum FY 81-5, Feb. 11, 1981 at 2-3.

Subpart 4, which authorizes a separate fund to provide special programs for disadvantaged students also requires that applicants be given priority on the basis of high concentrations of youth unemployment and school dropouts.[16]

Subpart 5 of the VEA retains another previous categorical VEA program as a separate sub-allocation for consumer and homemaking education.[17] At least one-third of the funds allocated for consumer and homemaking education must be used in economically depressed areas or areas with high rates of unemployment.[18]

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[15] The VEA in 1968 included the work-study and cooperative education methods as separate categorical funds. Sec. 171 and 181 of the VEA of 1963 as amended by P.L. 90-576 (20 U.S.C. §§1351 and 1371). States which applied for funds under either of these categories were required to distribute them to LEA's with priority for "areas that have high rates of school dropouts and youth unemployment." In the 1976 amendments, the categorical funding for cooperative education and work-study programs was eliminated and these two methods became "permitted uses" under the subpart 2 "Basic Grant", but the priority requirement was carried over. Sec. 120(a) of the VEA (20 U.S.C. §2330(a)).

[16] Sec. 121(b)(2) and 122(e) of the VEA (20 U.S.C. 2331(b)(2) and 2332(e).

[17] The 1968 VEA authorized a separate appropriation for consumer and homemaking education. States were required to use "at least one-third [of the funds]...in economically depressed areas or areas with high rates of unemployment for programs designed to assist consumers and to help improve home environments and the quality of family life." Sec. 161(d) of the VEA of 1963 as amended by P.L. 90-576 (20 U.S.C. §1341(d)).

[18] Sec. 150(d) of the VEA of 1976 (20 U.S.C. 2380(d)).

C. Major Findings, Conclusions and Recommendations

We identified four major issues raised by the application approval priorities and their federal legal framework:

(1) What is the meaning of the provision relating to "economically depressed areas" (EDA);

(2) What is the meaning of the term "new programs";

(3) What does it mean to "give priority" to these factors; and

(4) How do these application approval factors relate to the other priority requirements for specific programs and permitted uses?

The remainder of this section describes our major findings, conclusions and recommendations applicable to each.

1. The Meaning of the "Economically Depressed Area" Provision

The VEA requires priority to be given to applicants which "are located in economically depressed areas and areas with high rates of unemployment, and are unable to provide the resources necessary to meet the vocational education needs of those areas without Federal assistance."[19]

We found the meaning of the economically depressed area factor to be unclear. Although this factor is commonly referred to as the "economically depressed area" or "EDA factor" the statute sets out three components: economically depressed area, high unemployment, and inability to meet vocational education needs without Federal assistance. This EDA factor could be viewed as three separate and distinct measures (unemployment rates, location in a geographic area designated as economically depressed, and below average revenues for vocational education), any one of which being a sufficient basis on which to receive priority. It is also capable of being understood as a single measure in which all three factors must be satisfied to receive priority. ED's use of the statutory conjunctive "and" between these terms at one place in the 1977 regulation and "which" in another section did not clarify this definition, but rather created a third option which consists of two alternative measures: (1) economically depressed areas which are unable to provide the resources necessary and (2) areas with high unemployment which are unable to provide the resources necessary.

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[19] Sec. 106(a)(5)(A)(i) of the VEA (20 U.S.C. §2306(a)(5)(A)(i)).

ED's application of the EDA factor to the states has been inconsistent. Some states have been permitted to use only one of the three possible measures to satisfy the statute, whereas others have been required to combine at least two of the three possible measures. None of the states we researched understood the meaning of the third component of the EDA factor "unable to meet the vocational education needs without federal assistance," therefore, none used it.

The EDA priority is also unclear because neither the statute nor ED has ever clarified what is meant by the term "area". Area could be a subpart within a recipient's geographic border (*i.e.*, a neighborhood with high unemployment), a portion of the state or a region of the country. Most of the EDA measures used by states to determine the "priority" a specific recipient's application should receive are for areas which are *larger* than the geographic area for a single recipient. One state uses an EDA measure created by the Department of Commerce which qualifies 95% of the districts in the state as economically depressed. The measure does not significantly distinguish among applicants on the basis of need for vocational education or ability to pay, and ED's proscription against EDA measures which result in a "yes" or "no" designation did not resolve these problems.

A more detailed discussion of these findings concerning the EDA factor is contained in section II of this chapter.

2. Meaning of "New Programs"

The second issue discussed in this chapter concerns the meaning of "new programs." We found the term to be conceptually vague and that the legal framework added to the confusion rather than clarified its meaning.

On one level, "new programs" is a simple concept: an applicant proposing a program which it has not previously offered is clearly new. "New" can also mean innovative approaches, new curricula or restructured programs. Rather than narrowing the concept, ED added to it the notion of expansion, thereby enlarging it to respond to the goal stated in the Act of meeting "new and emerging manpower needs and job opportunities."[20] Some states use this expansion component to justify the purchase of new, or replacement of obsolete, equipment (in an existing program), or the expansion of facilities to accommodate a larger numbers of students. Other states, concerned with the legality of such a broad definition, limited the term to absolutely new, first time programs.

ED has left the precise method of ranking applicants of new programs to the states, and limited its guidance to describing alternative measurement. Initially, ED permitted states to use two measures: the proportion of an applicant's budget which is for new programs or the proportion of its programs which are new.[21] Despite the warning from the DSVPO Task Force that the use of the actual number of new programs would disadvantage, small, economically disadvantaged districts unable to initiate large numbers of new programs, ED has subsequently added this as a third option.[22]

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[20] See e.g., BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3.

ED's guidance as to the definition of new programs has been inadequate to help states counter possible abuses in applicant identification of "new" programs. Some state agencies, under state law, must approve vocational education programs in LEA's and post-secondary institutions. These agencies use their information sources and delegated authority to monitor new programs so as to prevent duplication, ensure proposed programs are carried out, and prevent recipient relabeling of old programs as new. These states indicated that they try to review applicant designations of new programs, but still believe duplication and labeling of old programs as new to be a problem. States without such a process indicated they accepted an applicant's designation of a program as new, and were not in a position to prevent duplication or relabeling.

Finally, ED has not offered any guidance with respect to the duration of new program funding.

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[21] Id. at 3.

[22] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 4.

Even though a multi-year grant would be more beneficial to the poorer recipients and enable them to absorb gradually the on-going costs after the start-up period of a new program, most states do not make multi-year new program grants for fear of violating funding requirements and incurring an audit exception.

The details on these new program issues are included in section III of this chapter.

3. Meaning of "Give Priority"

We found the application approval requirement to be inadequate because it fails to describe how a state is to give priority to applicants proposing new programs or applicants located in EDA's. The statute does not indicate what application approval or fund distribution mechanisms are to be used to give priority. Assuming a variety of mechanisms can be used, ranging from separate funding pools to a one-step formula factor, it does not indicate how priority is to be given under these different mechanisms. And it leaves unanswered the key issue of how much priority must be given to applicants with priority needs or uses.

ED has not addressed any of these issues in a clear, consistent or comprehensive manner. ED's interpretations have focused almost exclusively on (1) distinguishing between giving priority under so-called "one-step" or "two-step processes, and (2) specifying how application approval factors should function as factors in a formula.

Unfortunately this one-step/two-step dichotomy failed to take into account the key elements of the application approval and fund distribution methods actually used by states for VEA funds, thereby ignoring significant differences among various methods. One general method of allocating VEA funds is by applicant entitlement generated by a formula where all approved applicants receive varying proportions of the state VEA allocation. Another is the project application method where applications are ranked and often fully funded in rank order based on the amount sought in the application.

ED's policy guidelines do not recognize the differences between these methods. Consequently, they ignore how priorities can be given under a project approach, or simply that they cannot be met using this method. This has been a critical omission since many states use the project method of funding for at least some VEA purposes.

Although not reflected in formal interpretations, ED has approved the project method of funding. However, its failure to clarify how priority factors (and fund distribution factors) can be used under the project method has permitted states to incorporate these priority considerations in the project method in such a way that they have virtually no effect on the allocation of VEA funds. This occurs, for example, when a state uses these priority considerations to rank applicants to establish priority for funding, but where the amount of funds designated for that project statewide is sufficient to fund all applicants. In this case all applicants receive all the funds they apply for and the ranking is simply an academic exercise. Such problems have been ignored by ED.

We found ED's interpretation that states must give priority to EDA and new program factors by assigning them a numerical function and including these measures as variables in a one-step or a two-step funding formula to be an inadequate way "to give priority." These factors are inappropriate for inclusion in any mathematically scaled funding formula because they identify qualities that are inappropriate for quantifying on a continuous scale. They are particularly inappropriate to be included in ED's "one-step" formulas with the more precise, scaleable funds distribution factors.

In contrast, we found funding pools for new programs, such as are used in several states, to be an effective method of giving priority in application approval. ED, however, has not provided guidance on the use of funding pools for prioritizing purposes. States were unsure how pools related to EDA, the other applicant approval concept, or the funds distribution factors. These issues will be analyzed in greater detail in section IV of this chapter.

4. Function of Other Priority Factors

We found the dropout and youth unemployment terms which are the basis for the additional priorities for certain of the subpart 2 uses (i.e., work-study and cooperative education) and subpart 4 special programs for the disadvantaged to be conceptually clear. However, states experienced difficulty applying the concept of youth unemployment because data on youth unemployment, like adult unemployment, are reported for areas broader than most recipients. ED has given no guidance on how to deal with measures that are not recipient specific, e.g., use of proxies or proration, and states have experienced difficulty combining such measures with recipient-specific measures.

We also found the legal framework to be unclear about how these additional priority factors relate to the two application approval priority factors or to the funding formula requirement. ED did not provide clear and consistent guidance as to how application approval priorities and these additional priorities are to be combined. For instance, states were not sure whether the EDA factor in the consumer and homemaking allocation was the same as the EDA application approval priority, or how they related. Nor were they clear whether the youth unemployment concept applicable to work-study, cooperative education and subpart 4 was to substitute for, or was in addition to, the application approval priority factors.

We recommend that Congress address these issues and clarify the meanings and functions of the application approval priority provisions.

Specifically, we recommend that Congress eliminate the EDA priority factor as currently constituted. We suggest that if Congress wants to interrelate vocational education and economic or labor market disparities, it adopt other specific mechanisms for ensuring the responsiveness of vocational education in areas experiencing economic problems. It is clear that inclusion of a measure of EDA as a factor in a funding formula is not an adequate mechanism for satisfying this congressional objective as long as the measure of EDA is for areas which are larger than those served by individual recipients. Further, we recommend that the Department of Commerce concept of economically depressed areas not be used as a factor for prioritizing or approving recipient applications. This measure identifies the majority of recipients as economically depressed in many states and fails to distinguish among recipients that by any reasonable standard are very different in terms of economic depression and fiscal ability. Unemployment data, although more up-to-date, also presents inadequate information on which to base funding decisions. These data are usually not specific to the recipient's area and treat recipients with differing economic health the same. Such an inadequate measure should not be part of a legal framework distributing funds among recipients.

If Congress intends VEA funds to be used to develop new vocational education programs, we recommend that it clarify the term "new." Although Congress may want to adopt ED's interpretation, which includes new _and_ expanding programs, we recommend that it adopt a legislative definition to specify whether new or modified equipment and facilities are included in the definition. We make no recommendation as to precise definitions because the options vary with policy objectives sought. For example, if Congress intends to improve access to quality programs, it could do so by defining a new program priority to be the expansion of existing programs that meet a "quality" or "program demand" threshhold. If Congress wants to encourage innovation in vocational training it could adopt an "absolutely new" standard.

With regard to the third issue, the meaning of _giving priority_ to applicants, we recommend that Congress specify the options available to states and clarify the meaning of this term.

Specifically, Congress should consider requiring that states either: (1) establish _funding pools_ for each priority (_i.e._, separate pots of money to which recipients submit separate applications for such funds); (2) require recipients to set a specified amount of funds aside for each priority as a condition to receiving general VEA funds (_i.e._, set-asides); or (3) require that the priority criteria operate to eliminate some proportion of applicants (_i.e._, a cut-off point).

These options are analyzed, with some additional clarifications in section IV of this chapter.

Our final recommendations concern the additional priorities for areas with high youth unemployment and school dropouts applicable to certain uses under subpart 2 (work-study and cooperative education) and subpart 4 (special programs for the disadvantaged) and subpart 5 (consumer and homemaking education programs) the priority for economically depressed areas.

In the context of the general application, and the priority and fund distribution provisions of the VEA, these additional priorities for work-study, cooperative education, and subparts 4 and 5, add a level of complexity that appears unwarranted, particularly since the general fund distribution factor for low-income persons is probably a reasonable proxy for youth unemployment and school dropouts, and the economically depressed area priority for consumer and homemaking education is also applicable to the whole of the VEA. Consequently, we see little to be gained by continuing these separate priorities.

If Congress, however, intends separate or additional priorities to be given effect, it should clarify the mechanisms to be used to give any additional priority intended. We have concluded that including these as additional factors in a formula fails to give much additional priority and dilutes the impact of the other fund distribution factors. We suggest that Congress adopt a prioritizing mechanism which parallels the mechanism we have recommended for the application approval priority. The use of set-asides, funding pools and cut-off points would ensure that a certain portion of VEA funds would be applied to each use and distributed with a limited number of factors.

With respect to the minimum percentage expenditure (33 1/3%) of the subpart 5 funds consumer and homemaking funds in economically depressed areas, we have concluded that the priority accomplishes little. Under every EDA measure created for the EDA application approval priority which we examined, more than thirty-three percent of the recipients qualified as economically depressed areas and received priority treatment. This means that the consumer and homemaking funds can be and are distributed by states without concern for targeting on any special areas. If Congress intends an additional EDA priority for subpart 5, Congress must either specify a general EDA priority measure which identifies fewer than the minimum percentage, or increase the subpart 5 percentage for economically depressed areas.

We also recommend that Congress not require states to use area concepts such as youth unemployment to prioritize applicants for work-study, cooperative education and subparts 4 and 5. Rather, we recommend that all priority measures be recipient-specific.[23]

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[23] Although school dropout rates are recipient-specific, an additional problem inheres in their use: in many states dropout data on school districts are reputed to be unreliable because of different methods of computation used by school districts and the difficulty of accounting for student transfers among schools within the same school districts.

II. Priority for Economically Depressed Areas

A. Purpose and Organization

This section of the chapter analyzes the so-called economically depressed area priority (EDA) one of the two application approval factors. This priority concept raises two related issues:

(1) What is the definition of EDA; and

(2) How is the factor to be measured?

These two issues are analyzed in this section. Section IV of this chapter analyzes how priority is to be given to EDA in the VEA legal framework.

B. Federal Legal Framework

Section 106(a)(5)(A) of the VEA requires states to prioritize among applicants on the basis of two factors. One of the two factors is:

> whether the applicant is located in an economically depressed area and an area with a high rate of unemployment and is unable to meet the vocational education needs without Federal assistance.

The concept, commonly called the EDA factor, became part of the Federal legal framework in 1976 when the Senate added EDA along with new programs as priority factors for application approval.

ED's interpretation has been that states are to adopt definitions and appropriate measures to meet this requirement.[24] In the October 1977 regulations, ED substituted

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[24] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3.

"which" for the final conjunctive "and" in the statutory description of the EDA priority, thereby requiring that the Five-Year State Plan "describe how the State Board ... determines economically depressed areas and areas with high rates of unemployment...."[25]

Under ED's initial interpretation, states were required to include at least two measures of the EDA factor: (1) high unemployment rates and (2) "inability to provide resources for vocational programs."[26] ED prohibited states from using the Department of Commerce EDA measure as the "sole factor." [27] Subsequent policy statements retained these two measures, referring to them as the "recommended measurements for EDA, and "encouraged" states not to use the DOC EDA measure.[28] At no point, however, did ED provide guidance on how states should measure "inability to meet vocational education needs" in this priority.

ED has not allowed states to use the definition of EDA developed by the Department of Commerce (DOC) since the sole measure operates as a discontinuous rather than a continuous measure.[29] In other words, the DOC measure gives a yes-

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[25] 34 C.F.R. §104.182(c)(1).

[26] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3.

[27] Id.

[28] See e.g., Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 4.

[29] Id.

or-no response rather than a gradation of economic depression. The DOC measure is a composite of several economic indicators, including unemployment. Although the DOC measure of EDA cannot be used alone, ED has allowed it to be used in conjunction with other measures of unemployment or need for vocational education funds which yield numerical indicators of economic needs.[30] And at some points, ED's policy manuals have encouraged the use of the EDA definitions and measures used in "CETA".[31]

More recently, ED has permitted states to use unemployment as the sole means of defining and measuring the EDA priority. States may use either state or national unemployment data.

C. Summary of Findings and Analysis of Legal Framework

We found that even though the intent of Congress to target funds on needy applicants is clear, the precise meaning and measure of the EDA priority is unclear. We have identified five issues relating to the definition and measurement of the economically depressed area concept:

(1) The relationship among the three EDA concepts (EDA, unemployment and inability to meet vocational education needs);

(2) The definition and measurement of area;

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[30] This is documented in greater detail in chapter 4.

[31] See e.g., Draft Information Manual, Nov. 1979 at 4. ("The state may wish to consider definitions used by CETA or other programs.")

(3) The definition and measure of EDA;

(4) The definition and measure of unemployment; and

(5) Inability to provide vocational education resources.

1. Relationship Among the Three EDA Concepts

The legal framework is unclear as to the definition of the priority concept. The EDA application approval priority consists of three parts: (1) location in an economically depressed area; (2) high incidence of unemployment; and (3) inability to meet the needs for education without federal assistance. The legal framework is unclear about the relationship among these three concepts. The statute uses a simple "and" conjunctive which could signify three separate components to be combined numerically to obtain a "priority" measure. On the other hand, the use of "areas" with reference to both economic depression and unemployment suggests two types of recipients both of which are qualified by their inability to provide resources necessary for vocational education. Finally, it is possible to read these as one factor having three dependent components -- economically depressed areas having high unemployment and an inability to provide resources.

Further confusion was created by the similarity of the application approval factor "unable to meet the vocational education needs without Federal assistance" and the fund distribution factor "relative financial ability." It was unclear from the statute whether separate consideration must be given to these concepts at both the application approval and fund distribution stages or whether inclusion of relative financial ability as a funds distribution factor would suffice.

Although ED provided an interpretation through the regulations and policy guidelines that the priority was defined by at least two characteristics, unemployment and inability to meet vocational education needs, it also contradicted that interpretation by permitting states to use unemployment as the sole measure.

Currently, two of the four states we researched were using county level unemployment as their sole EDA definition, in at least one instance doing so with OVAE's oversight. Both of the states using two factors combined an EDA factor with county level unemployment rates. One state used the state aid ratio with unemployment; the other state used the DOC measure of EDA. No state used the portion of the definition concerning the inability of a recipient to meet vocational education needs, aside from incorporating a factor for relative financial ability in its distribution formula.[32] We agree with dropping out inability to meet vocational education needs from the EDA concept. The fund distribution factors of relative financial ability and low-income capture much of this "inability." Inclusion of the same concept as an application approval priority and a fund distribution factor would make little sense.

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[32] One state created a measure of "training needs" in its first formula, using Department of Labor Statistics on available jobs.

2. The Concept of "Area"

Two of the three concepts in this application approval priority refer to areas (i.e., economically depressed areas and areas with high unemployment). The statutory language indicates that "area" is larger than simply that served by the LEA or OER, e.g.,"applicant is located in an economically depressed area." The statute provides no guidance on how large this area can be or what proportion of a state's total area can be considered economically depressed or afflicted with high unemployment.

The fact that an application approval criterion applies to an area larger than a single recipient is not necessarily a problem if the criterion is used only to determine which applicants are eligible for funding; that is, the criterion is used only to establish an eligibility threshhold. Serious problems, however, have arisen from ED's attempt to use area criteria in funding formulas. The difference between the two uses of criteria is significant. An eligibility criterion generally gives a "yes-or-no" answer, whereas, in contrast a fund distribution factor gives a mathematical value which determines the amount of funds an applicant will receive.[33]

Area criteria should not be used as fund distribution factors because they may provide inaccurate information about individual recipients within the area. The mathematical value of an area criterion will be the average for the whole area, but recipients within the area may be very different. For example, in an area of high unemployment, there may be school districts whose residents are predominantly wealthy and employed, and school districts whose residents are poor and largely unemployed.

The use of an area measure as a criterion for eligibility poses fewer problems because other criteria are used to determine the amount of funds each eligible recipient will receive. ED has not addressed the problem of using area concepts as funds distribution factors. The difficulties for states and the anomalies for VEA funding this has created are discussed below.

3. The Term "Economically Depressed Area"[34]

The definition and use of the application approval priority for economically depressed area have created significant problems. These problems arose because ED, by interpretation, sought to convert a concept that was appropriate only for determining eligibility of applicants, into one that could also be used to govern the amount of VEA funds applicants would receive.

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[33] For further discussion, see section IV at p. 47.

[34] As used in this subsection "Economically Depressed Area" refers to the separate term by that name rather than the lumped statutory concept often referred to as the "EDA factor" discussed earlier which includes economically depressed area, areas of high unemployment and inability to meet vocational education needs without federal assistance.

A number of states used the Department of Commerce designation of economically depressed area. This gave a yes-or-no answer. Because of this fact ED discouraged its use. As discussed above, we find no inherent problem in a yes-no measure so long as it is used only to establish eligibility. ED's objective, however, was to require a measure of EDA that could be mathematically scaled in a funding formula.

ED did not completely bar states from using Department of Commerce EDA designations. Rather, it recommended that it be used only in conjunction with other measures.[35]

In several early policy statements, ED required that at least two of the three measures must be included.[36] Later model formulas from the DSVPO Task Force implied that a measure of general unemployment could be used alone for EDA, and discouraged states from using the Department of Commerce designation of depressed areas because it yields a yes-no identification rather than a numerically scaleable response.[37] One draft of ED's fund distribution manual endorsed the use of the economically depressed area measure used in CETA, but this recommendation was absent in later drafts.[38]

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[35] The Vocational Education Task Force recommend that ED also not permit use of the Department of Commerce EDA data source because it is outdated and relates to large areas.

[36] _See e.g._, Discussion Manual, Suggested Procedures for Federal Fund Distribution, June 1979 at 1.

[37] Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 4.

ED's shifting interpretations of the EDA concept and its measurement have created confusion among the states.[39] One state followed ED's advice about combining Department of Commerce measures with others but later dropped this EDA measure after receiving civil rights and MERC/Q complaints. Another state sought to compile its own composite measure using recipient-specific data statistically correlated with other measures of economic depression, but was challenged by ED.

State research also confirmed the predicted inaccuracies created by the area measure of EDA. Several states we researched reported that the use of area data for economic depression made recipients that serve wealthy, economically vital areas appear to be poor and economically depressed. For example, in North Carolina, Charlotte-Mecklenburg is a relatively wealthy area but is considered to be economically depressed because of the wide area covered by the EDA designation.

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[38] Compare DSVPO/BOAE Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 4, with Draft Information Manual, Dec. 1979 at 7; DSVPO/OVAE Program Memorandum FY 81-5, Feb. 11, 1981 at 4.

[39] Compare Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 with Draft Information Manual, Dec. 1979 and DSVPO/OVAE Program Memorandum FY 81-5, Feb. 11, 1981.

For the same reason, Beverly Hills in California is considered economically depressed even though numerous other statistics which are recipient-specific confirm that Beverly Hills is not.

4. The Term "High Rate of Unemployment"

With ED's approval a number of states have moved from using an EDA measure alone or in combination with another measure, to the use of "unemployment rates" as the sole measure of this application approval priority. Of the four states researched, three used unemployment rates alone or in combination as the factor for this priority.

None of these states use unemployment rates to determine an applicant's eligibility; rather all use these rates as a factor in a fund distribution formula. This creates problems because unemployment rates, in most states, are not calculated for areas coterminous with the boundaries of recipients, but for larger areas which can include recipients with widely varying unemployment rates.

Despite these problems, ED has allowed the use of unemployment as the sole measurement of this priority. It has, however, prohibited states from prorating the numbers to recipients.[40]

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[40] One state we reviewed which prorated the data was "encouraged" to discontinue that method and use county data. If recipient-specific data are unavailable, proration of multi-recipient data to specific recipients would in most cases appear to provide no more or less accurate results than the use of area data without proration.

5. The Term "Inability to Meet Vocational Education Needs Without Federal Assistance"

ED has given no guidance on the appropriate measure of inability to meet vocational education needs without Federal assistance. Every state we researched ignored this measure.

If ED's silence on this issue is to be taken as an indication that this concept appears to be very similar to "relative financial ability" (the fund distribution factor) and that its use as a separate application approval criterion would be redundant, we agree.

D. Recommendations

Because the EDA and unemployment measurements raise such serious problems, we recommend the application approval priority for "economically depressed areas" not be used in the VEA. The most serious problem with the factor is its reliance on data available only for broad areas, instead of recipients. Real differences among recipients are washed out in the use of area factors, distorting the allocation of VEA funds and contradicting the equalizing goals of the VEA.

This distorting effect is even more pronounced under ED's interpretation that these application approval criteria are to be used as funds distribution criteria. In a funding formula, factors that are not recipient-specific diminish the impact of more salient factors that are.

As discussed above, these criteria are less objectionable as threshhold eligibility criteria since the distorting effect of area measures can theoretically be compensated for by a distribution method that relies solely on recipient-specific factors.

III. Priority for New Programs

A. Purpose and Organization

This section of the chapter analyzes the definitional clarity of the second of the application approval priorities: the priority for applicants proposing programs new to the area to be served, designed to meet new and emerging manpower needs and job opportunities in the area (and where relevant in the state and nation).

We have identified two issues which are discussed in this section.

(1) What is a "new program"; and

(2) What mechanisms are states to use to monitor new programs claims and prevent potential abuses?

Issues relating to the methods of giving priority to new programs are discussed in section IV of this chapter. The related concern about the meaning of the prohibition against denying funds for new programs to fiscally distressed applicants, is discussed in Chapter 5.

B. Federal Legal Framework

In 1976, the VEA amendments included, for the first time, a requirement that states give a priority to applicants that propose "programs new to the areas to be served and which are designed to meet new and emerging manpower needs and job opportunities in the area, and where relevant, in the State and the Nation."[41] This amendment originated in the Senate as one of the two application approval priorities proposed in its VEA amendments, and was adopted verbatim by the Conference Committee. No parallel amendments were proposed by the House.

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[41] S. Rep. No. 94-482 at 360.

The Senate did not intend to require that states fund only new programs. This is evidenced by the amended statement of purpose which was also taken from the Senate bill:

> It is ...the purpose of this part to authorize Federal grants to States to assist them...to extend, improve, and, where necessary, maintain existing programs of vocational education.[42]

The Senate Report, in recommending the new program priority clarified that it intended that "successful ongoing programs should continue to receive assistance."[43] The report suggests, however, that in a competition between ongoing programs and new programs, Federal funds should probably be used for new programs: "However, with the development of new vocational programs competing for limited dollars, the State Board may have to decide to fund new and innovative programs, allowing State and local funds to pick up the costs of some operational programs."[44]

ED has never clarified the relationship between the new program priority and the "where necessary maintain existing programs" language of the VEA statement of purpose. This failure to clarify may have been based on the Conference Report which indicated that the statement of purpose was not intended to authorize the Commissioner to apply a "strict litmus test of absolute necessity before an ongoing program can be funded."[45]

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[42] Sec. 101(1) of the VEA (20 U.S.C. 2301(1))(Emphasis added.)
[43] S. Rep. No. 94-482 at 70.
[44] Id.

ED interpreted these admonitions as establishing a priority for new and expanding programs: "the new program may be similar to other ongoing programs but new to a particular service area or a major expansion of a program to meet unemployment (sic) needs..."[46] ED has concluded that the Federal framework requires the states to define this term. No further guidance on the definition of new programs has been provided.

ED has issued several statements on how applicants proposing "new" programs could be ranked. In 1979 it stated that "the most equitable way to compute the 'new programs' factor" is the percent of the applicant's total budget which is allocated to new programs, or the percent of the applicant's total number of programs which are new.[47] It did not permit the use of the actual number of new programs proposed by an applicant.

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[45] H.R. Conf. Rep. No. 94-1701 at 214.

[46] BOAE/DSVPO Suggested Procedures for Federal Fund Distribution, June 1979 at 2.

[47] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 5.

This was based on the DSVPO Task Force which concluded that the use of numbers of programs alone rather than percent of the budget would penalize smaller and poorer districts.[48] Later ED reversed itself and authorized the use of any of the three methods, including the total number of proposed programs.[49]

C. Summary of Findings and Analysis of Legal Framework

The new program criterion poses three problems: (1) the meaning of "new programs"; (2) the measure of new programs; and (3) the appropriate methods to monitor the identification of and need for new programs.

1. Definition of New Programs

ED has defined new programs to include both completely new programs and major expansions of existing programs. The addition of the "major expansion" concept has substantially opened up the new program concept. This opening was widened further by ED's position that any further definition of new programs should be made by the states. Thus, there has been no interpretation of whether a "major expansion" of an existing program would include, for example, the purchase of additional typewriters for a business course, a new piece of test equipment for an auto mechanics course, or may require a new course within an existing program sequence.

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[48] Id.

[49] See e.g., Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 7. In this and later manuals ED does not recommend this method but merely notes that it could penalize smaller, fiscally needy districts.

All states we researched adopted their own definition of new program. In most cases the definition was more restrictive than ED's authorization. One state distinguished between instructional and non-instructional activities. Instructional "new program" were required to be completely new and not additive, approved by the state department after a review of the transportation, instructional service and labor market needs components. Non-instructional activities were required to be activities which were never done before. A second state adopted as a definition that a recipient must demonstrate that the program or activity is completely new, and not just a quality improvement, and not available elsewhere. A third state narrowed ED's interpretation by adding "and is being offered for the first time by that specific school or post-secondary institution" and specifying programs not considered new:

(1) changes or modifications within a course or a curriculum of an existing program
(2) the addition of options to existing programs
(3) the addition of a laboratory, shop, classroom, or new equipment to an existing program.

Only this last state prohibits new equipment as a new program expense. Several states preferred a new equipment focus to the definition because of the ease of monitoring this nonrecurring costs. We were told that definitions which stressed programmatic dimensions are difficult to monitor.

Several states expressed concern that if they were to adopt ED's expansive definition, they would be subject to an audit exception. One state narrowed the concept of new programs to new program equipment to insulate itself from just such a challenge.

We found no evidence that any of the four states had given meaning to the phrase "new and emerging manpower needs and job opportunities"[50] in the definition of new programs. New programs are initiated by applicants and little or no review of these designations by states takes place. Those that do monitor the self-identification process only verify whether a program is actually new, and do not conduct a quality or needs assessment.[51] It is our impression that the planning process, which results in an applicant proposing a new program, takes place at the LEA or post-secondary level, with the state exercising relatively little control over which new or expanded programs are proposed.[52] One state, however, did indicate that it reviewed new program proposals for duplication of courses, equipment and facilities among nearby vocational education programs, and had refused to fund new programs where an applicant's students could enroll in that course nearby or where the program could be offered by the applicant in another applicant's facilities.

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[50] One state included a measure of training needs in its fund distribution formula which compared training opportunities to job opportunities. ED required that the formula factor be eliminated. We were not able to determine whether this factor was included to give meaning to this phrase.

[51] One state, which does monitor all programs does so primarily for non-duplication. It plans to initiate a state-wide needs assessment to give greater depth to its monitoring.

[52] We were not able to judge to what extent information from the state planning process, relating to new and emerging manpower needs and employment opportunities, informs and influences applicant decisions to propose new programs.

ED has never addressed the important definitional issue of how long a program can be considered new. Every state we reviewed recognized that a single-year funding cycle for new programs deterred poorer districts from identifying new programs. Poor districts are often unable to assume the full expense in year two of a new program. This may deter fiscally distressed applicants from applying for new program funds because of lack of other funds to continue the program when new program funding ends.

Despite their concern with the multi-year funding for new programs, most states were concerned with possible audit exceptions if they expanded the years of funding. One state out of the four in our research sample adopted a definition of new programs which recognized a program as "new for the time period (usually one or two years) it took to train a student in the program." In that state, the funding amount declined in the second year.

Other states, which adopted a "new program" definition that focused on such non-recurring expenses as new equipment or construction, reported that this limitation avoided the necessity of later assumption of costs which would hurt low wealth districts.

2. Measuring New Programs

ED's current draft policy manuals permit states to use three measures of new programs:[53]

(1) the proportion of the applicant's total expenditures which are spent for new programs;

(2) the proportion of the applicant's total programs which are new; or

(3) the actual number of new programs proposed.

As described earlier, the DSVPO Task Force final report recommended against the use of the third measure, absolute numbers of new programs, because it was likely to disadvantage low wealth and small districts.[54] None of the states in our sample used this measure.

One state measured new programs as the ratio of the total number of new programs to the total number of programs.

A second state assigns a set number of points for new programs, a lower value for expansion and zero points for maintenance. If an applicant proposes one new program, it receives the maximum new program points and receives no greater number of points for proposing more than one new program. The same is true for expansion efforts.

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[53] OVAE/DSVP Program Memorandum FY 81-5, Feb. 11, 1981 at 4.

[54] Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 4.

The third state in our sample does not measure the number or percentage of new programs in the "new program" factor in its formula.[55] Instead, it uses its state expenditure limitation (the same as in its RFA measure) with the ratio of vocational education enrollment to total enrollment as the new program measure.[56] This has the effect of providing additional funds to lower spending districts that have smaller percentages of students enrolled in vocational education. Until 1980, this state had no new program formula element at all. Federal administrators said the formula was out of compliance and provided technical assistance to the state in the design of several elements. The formula, with the "revenue limits" new program measure, was approved for use in FY 81.

Less than a year earlier, ED officials had found another state to be out of compliance for using a measure called "training needs" for its new program component. This measure used jobs available over a three year period compared with number of persons being trained for jobs by institutions to measure the gap between available jobs and training opportunities. This state was forced to change to a measure which reflected proposed new programs.

We concluded that the ED has given inadequate and inconsistent guidance concerning the measure of new programs. Of the three methods used, the two which rely on the number of programs operate as incentives for recipients to subdivide programs into as many subcomponents as possible in order to increase the total number. The measurement which provides a contrast point score without concern for the number of new programs does not encounter this, but merely requires the creation of one new program. The measurement which uses the proportion of the district's expenditures for new programs also minimizes this incentive because a total dollar ratio will not operate to encourage subdivision, although it may encourage "overidentification."[57]

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[55] One state among the four in our sample does not use a new program factor, but has been permitted to use a funding pool instead, the funds from which are distributed on a project application basis.

[56] A similar measure is used to calculate RFA. In essence this merely increased the weight of the RFA measure.

3. Monitoring of New Programs

The VEA structure is silent as to methods states are to use to monitor new programs, or even whether they may leave the identification of new programs completely to the local recipients. This leaves a significant hole in the legal structure and one which causes some concern in states which lack tight internal controls over program design and implementation. Two common concerns among these states were with (1) abuse of the self-identification process and (2) the lack of connection between planning or needs assessment and new programs.

Every state we researched relied, to a great extent, on recipient self-identification of new programs and were concerned with the potential for abuse. States mentioned several forms of possible abuse: (1) relabeling pre-existing courses; (2) canceling a program for a year and resurrecting it as "new"; and (3) proposing a new program but failing to implement it.

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[57] This problem is compounded by inclusion of a new program factor in a states general VEA funding formula. Most states require applicants to match VEA funds received under these general formulas with local funds. This means that in the first year of a new program, applicants must come up with new local matching funds for new programs. This can act as a further deterrent to poor applicants proposing new vocational education programs. This will be discussed in detail in chapter 5.

The only states which appeared to be able to track and catch these abuses were those which reviewed, approved and monitored all program activities. Whether this was done appeared to be largely a function of the state agency's authority to take such action under state law. For example, two states require each recipient to have submitted and received approval from the state agency for each curriculum item, program, or activity for which it seeks to receive new program funding under the VEA. The state agency then has records of all approved courses which are used to confirm the self-identification process on the VEA applications.

The other states rely totally on the recipients' self-identification and acknowledge that they cannot monitor this process.

The VEA legal framework as interpreted does not currently require a connection between proposed new vocational education programs and the need for the new program activities. As noted, ED has ignored the part of the definition which makes such a connection and, absent pressure from ED, states have not developed any criteria for relating new programs to needs. One state was required to drop a training needs factor from its formula. Although it is not known to be a fact, several states believe some of the new programs which are proposed by applicants to receive additional VEA funds are proposed to qualify for additional funds rather than to meet pressing needs. One state we researched is initiating a needs assessment to explore this problem.

D. Recommendations

The new program factor is in need of more guidance as to both its definition and its monitoring.

We recommend that Congress define new programs so that the meaning of the phrase is clear to the states. We make no specific recommendation on this definition because the options vary in accordance with the specific policy objectives sought. We have identified four possible objectives by way of example, although clearly there are more:

(1) To fund programs that are completely new as determined by the uniform vocational education program code;

(2) To equalize access to vocational education programs among LEAs and participating institutions by adding programs in those which offer few vocational offerings;

(3) To improve access to programs within LEAs by expanding programs into additional schools; and

(4) To improve access to programs by expanding the staff and equipment in existing programs.

Any of these objectives could be advanced by narrowing and clarifying the definition of the term. A second alternative available to Congress is to require that the definition of new programs be determined by the state. If Congress adopts this second option, however, it should clarify the intended purposes of the new program requirement and set parameters on the possible components.

Currently, most planning for new programs appears to take place at the recipient level. Under the present law there is no requirement that recipients, to qualify for new program funds, show the relationship of the proposed program to manpower needs and job opportunities. Congress might consider requiring that the state's definition be developed in the planning process and reported in the planning documents.

If Congress is concerned with program duplication, it should consider including a requirement that a new program not duplicate programs readily accessible to the applicant's students and/or require that recipients show they have explored cooperative arrangements with nearby eligible recipients.

We urge Congress to specify that new programs may be funded for up to 3-5 years so that the least fiscally able recipients are not required to assume their cost after the first year. This would permit states to develop phase-out mechanisms for cushioning the transition from full Federal-state new program funding (see recommendation on this in Chapter 4) to greater state-local assumption of program maintenance costs.

With respect to the measurement of new programs, we found the current legal framework to be inappropriate and inconsistent. First, we conclude "new programs" is not susceptible to the type of quantifiable measurement that ED has required. Second, ED's standards have been inconsistent and unclear. Third, the emphasis on numbers and dollars for new programs has detracted from quality expansion.

As described in greater detail in section IV *infra*, we recommend that new programs be used as a "yes" or "no" factor for new program funding pools or as an amount of funds set-aside for new programs within a general grant to recipients. This will alleviate the measurement dilemmas created by ED's current interpretation of new program factors.

IV. Meaning of "Give Priority"

A. Purposes and Organization

The VEA requires states to give "priority" to applicants for VEA funds on the basis of their location in economically depressed areas and the proposal of new programs. States are also to use additional priority criteria when funding work-study, cooperative education, special programs for the disadvantaged, and consumer and homemaking projects.

This section of the chapter analyzes the meaning of "give priority". Specifically, we will analyze the adequacy of ED's interpretations of this phrase in light of Congress' intention in adopting these priorities in 1976, and actual state practice of using "funding pools" and "funds distribution formulas" to give priority.

Chapter 4 of this part will analyze in detail the relationship between the application approval priorities and the funds distribution factors, including the mechanisms ED has permitted and found to be consistent with both the application approval and funds distribution provisions of the VEA.

B. Federal and State Legal Frameworks

The VEA requires that states give priority to applicants seeking VEA funds on the basis of specified characteristics. Section 106(a)(5)(B) describes the two characteristics to be used in prioritizing among all applicants for VEA funds, i.e., new programs and EDA.

Since its first policy documents, ED has allowed states to "give priority" to the approval of applications by including EDA and new program measures as variables in the funds distribution formula.[58/] ED has also permitted at least one state to create a funding pool to give priority to the new program concept.[59/] When a priority is met by including it as a funds distribution formula variable, the priority is converted into a numerical value used in a formula. In contrast, a funding pool is a sum of money set-aside for a particular purpose (priority) for which applicants separately apply. Separate conditions can be placed on each funding pool.

Most of ED's interpretations of how priority is to be given to the two criteria have centered on the option of using either a so-called "one-step" or "two-step" process. Although it is clear that the formula method described above is the "one-step" process, significantly, neither of these processes is completely congruent with the funding pool mechanism which ED has apparently authorized, but not fully

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[58/] See e.g., BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 2.

[59/] ED also permitted another state to create a funding pool, but required the state to include a new program measure in its formula. Since that time, ED apparently has determined that the funding pools is an adequate prioritizing mechanism, because it has recommended that the statutory factor be eliminated and the funding pool be continued. ED has not addressed whether a funding pool can be set up for meeting the EDA priority.

explained, as a method for meeting these priorities.

ED's two-step process consists of step one, approval of applicants and step two, distribution of funds to applicants. The application approval priority factors are used in the first step to rank applicants. A cut-off point, identified by the state, is used to eliminate some applicants. Then in step two, the appropriate funds distribution factors are used to determine the amount of funds to be allocated to each of the applicants accepted for funding.

ED's one-step process describes the practice of combining the two application approval priorities and the two funds distribution factors in a single formula.[60] ED has required that states using this integrated process give the two fund distribution factors primary weight in the formula and the two application approval priorities secondary weight.[61]

Any other factor must receive less weight. ED gave as an example of an acceptable state policy using the one-step process a formula with four variables: the two application approval priorities (EDA and new programs) and the two funds distribution factors (relative financial ability and low-income higher cost students). Each of the two funds distribution factors were worth a maximum of 30 points, whereas the application approval considerations were accorded 20 apiece.[62]

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[60] ED has assumed that the one-step process would result in the funding of all applicants, in contrast to the two-step process in which the first step decides which applicants will receive funding. In fact, a one-step process could also be established that funded only some of the applicants. This would be accomplished simply by establishing an eligibility cut-off at a numerical value higher than the applicant having the lowest numerical value generated by the formula. General school finance formulas used by states often operate in this manner.

[61] See e.g., BOAE/DSVPO Manual for Federal Fund Distribution Procedures, Sept. 1979 at 2.

ED's early policy descriptions treated both the one-step and two-step processes as equal options.[63] Subsequent documents reflect ED's interpretation that the 1976 amendments anticipated a two-step process, but that it would allow states to use the one-step process in order to accommodate existing state practice of funding all applicants.[64]

In the one-step process ED has not required states to give the application approval priority criteria the relative weight accorded them in ED's example above. In subsequent interpretations ED merely required that "greater weight" must be given to the funds distribution factors than the application approval priority.[65] One state, with ED's technical oversight, adopted a formula that gave negligible weight to the application approval considerations. As in the case above, there were four variables: two application approval factors and two funds distribution factors. The application approval factors received .001 weighting each whereas other funds distribution factors received from .299 to .399 weighting apiece. This meant that only .1% of total VEA funds under this formula were allocated by each of the application approval priority factors.

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[62] Id. at 16.

[63] See DSVP/BOAE Suggested Procedures for Federal Fund Distribution, June 1979 at 2; and Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 2. In fact, in a letter sent to one state early in 1979, BOAE staff expressed the view "that the prioritizing can be made more effective by actually including the two factors in the determination of the amount of funds made available to approved recipients." Letter from Duis (BOAE) to Bissell, Feb. 6, 1979.

[64] This view was first expressed in the DSVP/BOAE Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 3. See also, Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 3, and Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Procedures, July 1980 at 5.

[65] See e.g., BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 2.

One state we reviewed originally used neither a funding pool nor a one or a two-step funding process for incorporating the new program priority. Instead it sought to give priority to new programs by requiring applicants to give an assurance that funds would be expended for new programs unless the applicant could demonstrate that funds should be used for other purposes. ED disapproved this administrative mechanism for meeting the priority on the basis, we were told, that this mechanism could not be monitored.

C. Summary of Findings and Analysis of Legal Framework

Although the VEA does not specify how states are to give "priority" to applicants meeting certain criteria, it clearly mandates that such a process take place. The term, without more, offers no information about the process of comparing applicants, or what is to be the outcome of this process. This incompleteness has been a major problem in the statutory structure which has not been eliminated by ED interpretations.

The confusion over these terms has been increased because the statute refers to giving priority in considering the approval of applications by eligible recipients. Based on the plain meaning of the words, the "approval of applications" appears to be a different and preliminary process in comparison to "determining the amount of funds... which shall be made available to those applicants approved for funding" referred to in subsection 106(a)(5)(B). Thus, taken literally, the words of the VEA would indicate that the two priorities operate at the stage of application approval and are separate from the later process that determines the amount of VEA funds that approved applicants receive. Because, however, the application approval and fund distribution provisions were taken verbatim without reconciliation from the Senate and House bills, respectively, ED was reluctant to apply these terms literally.

As a result of this reluctance, ED permitted states to use either a so-called "one-step" or a "two-step" process as described earlier. The two-step process separates application approval and funds distribution into a stage in which priority is given and a later stage in which funds are distributed. The one-step process attempts to combine the priority criteria and funds distribution factors in a single funds distribution formula.

Under both the one-step and two-step processes, as conceived by ED, the priority criteria are to be transformed into numerical values, e.g., the more new programs an applicant proposes, the higher the applicant's score on the new program variable. In the two-step process these numerical values would be used to rank applicants so that a cut-off could be applied below which applicants with lower scores than the cut-off would not be eligible for VEA funding. In the one-step process the priority criteria were also transformed into numerical values, but these values are mathematically combined with the numerical values for the fund distribution factors, to determine the amount of VEA funds an applicant would receive.

In ED's interpretation, the most important consideration appears to have been how to authorize states to fund all applicants, and to avoid any interpretation which would force states to leave any applicant out. ED viewed the one-step process as permitting the funding of all applicants.

Each of the four states we researched used the one-step process under which the priority criteria were transformed into fund distribution factors and combined with the funds distribution factors required by statute. States were aware that this method of "giving priority" actually diluted or negated the effect of the priority factor. This dilution occurred because (1) when factors are combined in a formula the effect of a single factor is diminished and (2) inclusion of even the most minimal weight for the priority factors was acceptable to ED.

Many states adopted ED's one-step formula, which included the priority criteria, only after ED found the states' prior distribution schemes to be out of compliance for failing to properly "give priority" to the application approval factors. ED had a significant role in the creation of the formulas in two states we researched. In one instance, ED recommended a one-step formula to a state director noting: "While not required, it is our view that prioritizing can be made more effective by actually including the two factors in the determination of the amount of funds made available to approved applicants."[66] Only one of the four states we researched was ever pressured by ED to use a two-step process.

A third method of giving priority, that of funding pools, has also been used by several states, and at least acquiesced in by ED. Under this method, a state designates a portion of its total VEA allocation to be used for new programs. This amount is put into a funding pool for new programs, and only those applicants proposing new programs are eligible to apply for funds from that pool. Once the number of eligible pool applicants is determined the state applies funds distribution factors to allocate the funds in the pool to the eligible applicants.

66/ Letter from Duis (DSVPO) to Bissell (Feb. 2, 1979).

State directors in the two states that use such funding pools thought this mechanism was a more effective means of implementing an actual priority because it became a funnel through which all applicants passed for funding. ED, however, seemed not to understand the functioning of a funding pool. One state with a funding pool for new programs was pressured to also create a formula factor (with a negligible weighting) for this priority. This was done rather than trying to demonstrate the effectiveness of the funding pool to ED.

A fourth method of meeting the new program priority was attempted in one state. It used a "rebuttable presumption" that all VEA funds were to be expended for new programs to effectuate the priority. Under this presumption, a recipient was to come forward with an explanation for the proposed use of VEA funds to maintain existing programs; otherwise, the funds were to be used for new programs. The state staff admitted that the use of an objective test to justify the maintenance of old programs was difficult to construct and apply. ED did not view this as carrying out the priority requirements for new programs, and required that it be eliminated.

We found that funding pools give considerable focus to the application approval priorities. Moreover, it is easy to determine the amount of "priority" given to a factor from the amount of VEA funds in the funding pool. A new program pool, for example, is used only to fund applicants for new programs. Applicants not meeting the new program requirement would receive none of these funds. We conclude that ED's interpretation that funding pools can be used to give priority to the application priority criteria endorses a potentially effective mechanism for giving priority in the application approval process. [67]

We disagree, however, with ED's interpretation that the requirement "to give priority" can also be met by combining application approval priority considerations with funds distribution factors in a single formula. First, the application approval factors in section 106(a)(5)(A) are inherently inappropriate for inclusion in a funding formula. Second, their inclusion in the formula minimizes both their importance and the importance of the fund distribution factors. At best their inclusion has made VEA fund distribution formulas into "hash" or worse, it has so diluted the impact of individual factors that states have been able to manipulate factors to achieve virtually any result they wanted.

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[67] ED has not been clear in its authorizations of funding pools to meet these priorities. ED staff informed at least one state we reviewed that funding pools were an acceptable alternative for meeting these priorities. In another state ED required that new programs be included in the formula even though the state proposed creating a funding pool for new programs. Later ED told the state that the funding pool was a sufficient method to meet the priority and urged the state to eliminate the new program factor from the formula. Either ED or the statute should clarify this.

A more complete discussion of the problem created by including application approval priority criteria in VEA funds distribution formulas is found in chapters 3 and 4 of this part, which more thoroughly consider formula issues. In this section, we only conclude that their inclusion in a formula does not have the effect of "giving priority" to the application approval considerations.

Although ED has issued numerous policy documents about fiscal issues which refer to the application approval priority provisions, it has never defined what was intended by the use of the phrase "give priority". All of ED's interpretations have defined "priority" in reference to funds distribution. For instance the one-step or two-step process interpretation merely describes the stage at which the application approval prioritizing occurs; it does not answer the more basic issue of how much priority must be given. So long as some priority, regardless how small, was given to the application approval priorities, it appeared that ED would approve the state's priorities - as long as the method used was "one step" or "two step". In one state we reviewed, the EDA and new program criteria each only affected .1% of the total amount of VEA funds.

It is our conclusion that the failure of the VEA to specify the methods to be used to "give priority" and the amount of priority to be given to these criteria, combined with ED's encouragement and approval of methods of "giving priority" that were clearly inappropriate, resulted in little or no actual priority being given to these application approval criteria.

D. Recommendations

The VEA's failure to describe the methods to be used to "give priority" and how much priority must be given is a major weakness in the legal framework. We recommend that Congress specify what the phrase means apart from the funds distribution requirements. In this regard, we recommend that Congress specifically prohibit application approval criteria from being included in a VEA funds distribution formula since these criteria are inappropriate for inclusion in any formula which determines the amount of funds a recipient will receive.

This recommendation and others relating to the inappropriateness of including the present application approval priority criteria in a funds distribution formula are futher discussed in Chapter 4.[68]

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[68] See Chapter 4 at p. 71.

If Congress wishes to retain the present application approval priority requirement, we recommend that it specify that "priority" is to be given by the state designating a prescribed minimum amount of VEA funds for a funding pool or a set-aside.

Further, we recommend that Congress clarify the relationship between each priority use of funds and the funds distribution requirements of the VEA.

V. Additional Priorities Applicable to Work-Study and Cooperative Education Programs and Subparts 4 and 5

A. Purpose and Organization

The VEA contains four provisions which specify additional factors which states are to use to prioritize among applicants for work-study, cooperative education, subpart 4 programs for the disadvantaged and subpart 5 programs for consumer and homemaking education.

The purpose of this section is to analyze these additional priority considerations in light of the following issues:

(1) Is the substance of these additional priorities clear; and

(2) How do these additional priority considerations relate to the general application approval priority criteria?

This section does not analyze the relationship of these additional priorities to methods states use to allocate funds to applicants for these uses (i.e., the use of funding pools, the project method of funding). These matters are considered in chapters 2 and 4.[69]

B. Federal Legal Framework

When VEA funds are used for work-study, cooperative education, special programs for the disadvantaged (subpart 4) and programs for consumer and homemaking (subpart 5), the state is required to "give priority" to applicants with certain characteristics or applicants located in certain areas.

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[69] See Chapter 2 at p. 60 and Chapter 4 at p. 100.

Work-study and cooperative education are listed among the twelve categories of permitted uses for Basic Grant funds under subpart 2.[70] The statute requires states to "set forth principles for determining the priority to be accorded applications" from LEAs for work-study programs. And these principles "shall give preference to applications submitted by local educational agencies serving communities having substantial numbers of youth who have dropped out of school or who are unemployed, and provide for undertaking such programs, insofar as financial resources available therefore make possible in the order determined by the application of such principles."[71] (Emphasis added.)

Although the substantive priorities for cooperative education programs are the same as those for work-study, *i.e.*, school dropouts and youth unemployment, the language of the priority is somewhat different:

> "priority for funding cooperative vocational education programs through local educational agencies is given to areas that have high rates of school dropouts and youth unemployment.[72] (Emphasis added.)

The same two priorities are specified for special programs for the disadvantaged under subpart 4, but again different language is used:

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[70] Sec. 120(b)(1)(B) and (C) of the VEA (20 U.S.C. 2330)(b)(1)(B)).

[71] Sec. 121(a)(2) of the VEA (20 U.S.C. 2331(b)(2)).

[72] Sec. 122(e) of the VEA (20 U.S.C. 2332(e)).

> "Grants to states under this subpart shall be used .... for allocation within the state to areas of high concentrations of youth unemployment and school dropouts,..."[73] (Emphasis added.)

Similar but more general criteria are set out as priority factors governing one-third of the funds for consumer and homemaking education under subpart 5:

> "At least one-third of the Federal funds made available under this section to each state shall be used in economically depressed areas or areas with high rates of unemployment..."[74] (Emphasis added)

Most of these priority provisions were contained in separate categorical programs for these purposes in the pre 1976 VEA legal structure.[75]

In 1977 when the previously categorical programs for work-study and cooperative education programs were merged as "permitted" uses, these retained their special priority criteria and subparts 4 and 5, which retained separate appropriations also retained their separate priorities.

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[73] Sec. 140(b)(1) (20 U.S.C. §2337(b)(1)).

[74] Sec. 150(d) (20 U.S.C. §2380(d)).

[75] The VEA amendments enacted in 1968 contained categorical funding provisions for consumer and homemaking, cooperative vocational education, and work-study which included the same priorities as described above. Sec. 161, 171 and 181 of the VEA of 1963 as amended by P.L. 90-576 Sec. 161, 171, and 181 (20 U.S.C. §1341, 1351, and 1361) (enacted Oct.16, 1968). The Subpart 4 special programs for the disadvantaged existed on a separate appropriation in the pre 1976 Act. (See 102(b) of the VEA of 1963 as amended by P.L. 90-576 (20 U.S.C. §1242).

ED has required states to apply the general application approval and funds distribution factors of section 106(a)(5) to these categorical programs. In general, ED has viewed the specific priority criteria applicable to these programs as being in addition to the general factors.

At one time, ED permitted states to use these additional priorities to substitute for the general EDA or unemployment measure when a one-step process was used for work-study and cooperative education.[76] However, in the Draft Fund Distribution Manual of July 1980, these separate priorities were interpreted as being "in addition to the other four required factors to be used in establishing relevant priority of applicants and distributing funds to approved applicants."[77]

ED's interpretations sought to reconcile some of the differences in language between the work-study and cooperative education priorities. First, in the 1977 regulations, ED changed the conjunction "and" in the cooperative education provision to "or", to clarify that states can give priority to either unemployment or dropouts.[78] ED did this to create a parallel construction with the VEA work-study priority which uses "or" to designate its alternative measures. Second, ED specified in the regulations that in the funding of cooperative education programs, priority should be given in a state's "review of applications."[79] And the regulations retained a reference to the work-study statutory provision that preference is to be given to applicants "insofar as financial resources available therefore make possible" but added the requirement that resources be distributed "in the order determined by the application of such principles."[80]

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[76] See Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 13.

[77] OVAE/DSVP Draft Information Manual for Federal Vocational Education State Grants, July 1980 at 12. With respect to the work-study and cooperative education, ED has required the application of these additional priorities whenever VEA funds are used for either purpose. ED has stated its position that "states may not legally circumvent those requirements by labelling 'coop voc ed programs' as 'vocational education programs' and funding the activity under Section 120(b)(1)(a)." See Comment/Responses to §104.531. 42 F.R. 53881 (Oct. 3, 1977).

ED has interpreted the EDA priority for one-third of the consumer and homemaking education funds (subpart 5) as a set-aside or funding pool for areas suffering from economic depression or high unemployment.[81] The language in subpart 4 (special programs for disadvantaged) is parallel to that in subpart 5: subpart 4 funds "shall be used... for allocation within the state to areas of high concentrations of youth unemployment and school dropouts." ED, however, adopted a different interpretation of the subpart 4 language: all subpart 4 funds do not have to be expended in such areas; rather, as in the case of cooperative and work-study programs, these priority criteria can be used as additional numerical factors in the VEA fund distribution formula.[82]

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[78] 42 C.F.R. §104.531(b). See explanation for the change in 42 F.R. 53885 (Oct. 3, 1977)(Comment/Response to §104.802 (a)).

[79] Id. In part, as discussed later, ED's later interpretations contradict the implication of this additional language by authorizing and recommending that application approval criteria be used as fund distribution factors. See p. 47.

[80] 42 C.F.R. 104.522(b).

[81] BOAE Policy Memo Re: Use of Consumer and Homemaking Funds, Aug. 8, 1977.

C. Summary of Findings and Analysis of Legal Framework

This legal structure raises three problems:

(1) The language used for the substantive priorities is unclear as to the similarities and differences between the prioritizing terms and whether different meanings are to be given to each;

(2) It is not clear how terms such as "youth unemployment", "communities", and "areas" relate to particular applicants for VEA funds; and

(3) The relationship between the additional priorities and the application approval priorities is unclear.

First, with respect to the substance of these priority factors, the legal framework leaves unresolved whether the differing language of each priority requires a different definition, method of implementation and measure for each. For example, priority for cooperative education is to be given to applicants serving "communities" with "substantial numbers"of dropouts of unemployed youth, whereas priority for work-study funds is to be given "to areas" with "high rates" of school dropouts and youth unemployment; and subpart 4 funds are to be used for allocation "to areas of high concentration of youth unemployment and school dropouts."

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[82] See Final Report of the DSVPO Task Force on Funds Distribution Procedures, June 1979 at 2.

ED took this essentially similar language of the priorities in subpart 4 and 5 and interpreted them as having different meanings, as discussed above. It is not clear whether this was intentional or fortuitous since no documents we reviewed discussed these interpretations.

All states indicated some uncertainty and confusion about how to give the additional priority required when operating these four programs. And we found variation in the manner in which states attempted to carry out these priority concepts. Only one state set up different measures for each of these; two others adopted a common unemployment and dropout measure using an area or community, and a percentage or number basis for each. One state created no statewide measure, but instead requires each recipient to distribute funds within its area on the basis of the priority factors. At least one state funded no cooperative vocational education because it did not want to meet the additional VEA requirements.

The use of terms in the VEA that describe factors affecting an area larger than a particular applicant also created problems for the states.[83] Some priorities specifically refer to "communities" or "areas" or "economically depressed areas"; in addition, measures of "youth unemployment" are only available for areas larger than most LEAs.

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[83] The only state which did not encounter this problem interpreted "area" to apply to an area smaller than a recipient. The lack of clarity in the statute does not preclude this interpretation.

ED never identified the meaning, measurement or prorating techniques to apply these broader geographic concepts to recipients. By contrast, data such as "youth dropout" which are collected by the recipients required no interpretative assistance.[84]

As presently set out in the VEA and interpreted by ED, these additional priority criteria for work-study and cooperative programs, and subparts 4 and 5 appear to add little but needless complexity to the VEA structure. With ED's urging, most of the states we reviewed included these priorities (except for subpart 5) as additional factors in VEA funding formulas. As the fourth, fifth or sixth factor in an already overly complicated formula, these additional priorities were functionally nonexistent.[85] The ineffectiveness was compounded by the use of date for large areas rather than for specific recipients.

The EDA and high unemployment area priorities for consumer and homemaking education programs have been ineffective for a different reason. In many states the majority of counties can be considered economically depressed under the Department of Commerce definition. Yet only one-third of the consumer and homemaking education funds must go to such areas. This means that the priority can be met even when the most prosperous areas of a state receive more funds than economically depressed areas.

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[84] However, as noted supra; school dropout data may not be very accurate in some states.

[85] This is discussed in greater detail in chapters 2 at p. 47 and 4 at p. 71.

D. Recommendations

If Congress wishes to continue to have separate priorities within existing priorities, we recommend that it amend the VEA in four ways:

First, we recommend that it clarify the terms of the priorities so that parallel priority considerations use the same structure and terms.

Second, we recommend that the statute clearly specify the method for giving priority to any additional criteria and their relationship to any general criteria for application approval and to the fund distribution factors.

Third, we recommend that any additional priorities be given through funding pools or set-asides if general fund distribution criteria are to be used to distribute funds among applicants. This avoids complicating funding formulas with criteria that may be inappropriate for determining the amount of funds an applicant is to receive.

Fourth, we recommend that the VEA specify the amount of priority that states must give to any additional priorities. Requiring states to give "priority" without specifying the amount of priority creates confusion and encourages states to adopt strategies for compliance which have little affect on how VEA funds are allocated.

CHAPTER 3

FUNDS DISTRIBUTION FACTORS

Chapter 3

FUNDS DISTRIBUTION FACTORS

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CHAPTER 3

FUNDS DISTRIBUTION FACTORS

I. Introduction

A. Purpose and Organization

The purpose of this chapter is to analyze the meaning and measurement of the funds distribution factors specified in section 106(a)(5)(B)(i) of the VEA. Specifically this chapter addresses the clarity, consistency and adequacy of the terms:

(1) "local educational agency" (LEA) and "other eligible recipients" (OERs);

(2) "relative financial ability";

(3) "relative number or concentration of low-income families or individuals"; and

(4) "the relative number or concentration of students whom they serve whose education imposes higher than average costs".

This chapter will not address the mechanisms through which these factors have been used to distribute VEA funds or the effects these factors have had on actual VEA allocation patterns. The former is the subject of the chapter 4; the latter is beyond the scope of this study.

This chapter is divided into four sections. The first section of this chapter gives an overview of the issues and summarizes our major findings, conclusions and recommendations. The second section describes the VEA's use of the terms "local educational agency" (LEA) and "other eligible recipient" (OER) to categorize eligible recipients for funds distribution purposes. The third section analyzes the specific funds distribution factors applicable to LEAs. The fourth section considers the funds distribution factors applicable to OERs. Detailed findings, conclusions and recomemndations are included in each section.

B. Summary of the Legal Framework

Section 106(a)(5)(B)(i) of the VEA specifies the "two most important factors" which states are to use to determine the distribution of VEA funds to local education agencies (LEAs) and other eligible recipients (OERs). For LEAs, the two most important factors are: (1) "relative financial ability of such agencies to meet the need for education in the areas they service" and (2) "the relative number or concentration of low-income families or individuals within such agencies." For OERs the two most important factors are: (1) "the relative financial ability of such recipients to provide the resources necessary to initiate or maintain vocational education programs to meet the needs of their students," and (2) "the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language."

These two funds distribution factors were added to the VEA by the 1976 amendments. Although previous versions of the Act expressed similar distributional objectives, they did not specify how these objectives related to the allocation of VEA funds to applicants.

For example, the 1963 VEA legislation required states to articulate in the state plan "policies and procedures... in allocating... federal funds to LEAs in the state... [which] ensure that due consideration will be given to... the relative vocational needs of all groups in all communities in the state."[1]

Congress, in the 1968 VEA amendments, sought to strengthen the specifications for funds distribution and introduced certain concepts such as "relative ability", which were more precisely spelled out in 1976.[2] In the 1968 amendments the concept of

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[1] Sec. 5(a)(2) of the VEA of 1963 (20 U.S.C. 1245(a)(2)).

[2] The relevant language of the 1968 amendments is as follows:

> (B) due consideration will be given to the relative vocational education needs of all population groups in all geographic areas and communities in the State, particularly persons with academic, socioeconomic, mental, and physical handicaps that prevent them from succeeding in regular vocational education programs.
>
> (C) due consideration will be given to the relative ability of particular local educational agencies within the State, particularly those in economically depressed areas and those with high rates of unemployment, to provide the resources necessary to meet the vocational education needs in the areas or communities served by such agencies,
>
> (D) due consideration will be given to the cost of the programs, services, and activities provided by local educational agencies which is in excess of the cost which may be normally attributed to the cost of education in such local educational agencies.
>
> (E) funds made available under this title will not be allocated to local educational agencies in a manner, such as the matching of local expenditures at a percentage ratio uniform throughout the State, which fails to take into consideration the criteria set forth in paragraphs (A), (B), (C), and (D).

Section 123(a)(6)(B)-(E) of the Vocational Education Act of 1963 as amended by P.L. 90-576 (20 U.S.C. 1263(a)(6)) (Oct. 16, 1968).

"relative ability" did not focus on "financial" ability, although that was implicit in its modification of "to provide the resources." In addition, "relative ability" appeared to include the concept of variation in need for vocational education since it was to take into account the statutory presumption that applicants in "economically depressed areas and those with high rate of unemployment" have a greater need for federal assistance.[3]

According to the House Report accompanying the 1968 amendments, the funds distribution provision was intended to prohibit a state from a distribution of VEA funds which ignored the relative ability of applicants to provide resources for vocational education.[4] However, the 1968 fund distribution provision retained the vague "due consideration" language of the 1963 Act.

In 1976 the House report critiqued the previous structure of the VEA as "too general in nature" to effectuate the ongoing intent to provide additional resources to school districts and agencies "most in financial need of these funds." Relying on a Congressional Budget Office study which found that the majority of states had failed to equalize the distribution of VEA funds among LEA's based on the equalization criteria of relative property wealth or relative family income of recipients, the House Committee concluded that "the States are not following the intention of the legislation."[5]

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[3] A similar presumption also appeared in subparagraph (B) of section 123(a)(b) which required that consideration in funding be given to the needs of persons "with academic, socioeconomic, mental and physical handicaps that prevent them from succeeding in regular vocational education programs."

[4] H.R. Rep. No. 1647 at 58 (July 8, 1968). (Section by Section Analysis) reprinted in [1968] U.S. Code Cong. and Adm. News 4189.

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[5] H.R. Rept. No. 94-1085, at 33-34. The text of the Report's criterion of the adequacy of prior fund distribution provisions is as follows:

"The second change has to do with the way in which States distribute their Federal funds within the State. The present law provides that States are to distribute these funds by giving due consideration to the results of periodic evaluations of programs, to the relative need for vocational education of population groups in the State (particularly those who are disadvantaged and handicapped), to the relative ability of school districts) (especially those economically depressed areas) to provide resources and to the excess cost of vocational programs. From our oversight of the program during the last two years we have found that these requirements are too general in nature to carry out the intention of Congress which was to provide additional resources to those school districts and agencies most in need of those resources to provide programs. A study conducted for the Committee by the Congressional Budget Office found that only 23 States under the current law are equalizing the distribution of Federal funds among local school districts if family income is used as a measure of equalization and 26 States are not so equalizing. The study also found that only 8 States are equalizing the distribution of these funds using property value as a measure of equalization and that 35 States are not. Clearly the States are not following the intention of the legislation; and we must accordingly modify the law to make it more specific.

For that reason the Committee has amended the provision regarding the distribution of funds within the State to require States to distribute Federal funds based on various factors showing the need for vocational education but particularly requiring that the two most important factors used must be, for school districts, the financial ability of these districts and the number of concentration of low income families or individuals within them, and for other public agencies, the financial ability of such agencies and the number or concentration of students whom they serve whose education imposes higher than average costs. The Committee intends "financial ability" to be defined as the property wealth per capita of local school districts and of other public agencies having a tax base and to be also defined as meaning the total tax effort of the area served by those schools and agencies as that effort is a percentage of the income per capita of those within the taxing body. We feel that such a definition will give a greater preciseness to our intention in trying to focus Federal funds on those schools districts and other public agencies most in financial need of these funds. For the same reasons we have included as the other important factor the number or concentration of low-income families, and the number or concentration of students whose education imposes higher than average costs. That factor, too, readily identifies those agencies most in need of this assistance."

Consequently, the House Bill included the two required distribution factors of section 106(a)(5)(B)(i) "to give a greater preciseness to our intention in trying to focus Federal funds on those school districts and other public agencies most in financial need of these funds."[6] And these were incorporated verbatim into the final bill as section 106 (a)(5)(B)(i).

C. Major Findings, Conclusions and Recommendations

1. Identification of Issues

We have identified three issues raised by the fund distribution factors provision:

- o Whether "local education agency" and "other eligible recipient" are sufficiently clear and appropriate categories of recipients for making distinctions in the distribution of VEA funds.
- o Whether the measures of relative financial ability are sufficiently clear and comprehensive to identify the most needy LEAs and OERs.
- o Whether the low-income and higher-cost student measures are adequate to readily identify LEAs and OERs most in need of VEA funds.

2. The Use of LEA and OER as Separate Categories of Recipients for Purposes of Funds Distribution

There are substantial differences between school districts and post-secondary institutions in legal structures, geographical service patterns, and funding sources. The VEA definitions of

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[6] *Id.*

LEA and OER, however, do not necessarily coincide with the commonly accepted distinction between school districts, which generally serve students through grade 12, and post-secondary vocational education institutions, which commonly are community colleges and area vocational centers.

The general definition of LEA in the VEA is so broad as to potentially include virtually all public post-secondary institutions, as well as public school districts. In contrast, the different fund distribution requirements of section 106(a)(5)(B)(i) appear responsive to real differences between school districts and post-secondary institutions. But the breadth of the definition of "LEA" has given states the choice to treat post-secondary institutions as LEAs or as OERs.

Because work-study and cooperative programs funded under the VEA are limited to LEAs, some states have included post-secondary institutions as LEAs to quality for these programs. We express no opinion on whether these programs should be limited to school districts; however, the pressure to qualify post-secondary institutions for work-study funding has resulted in some states designating post-secondary institutions as LEAs even though the fund distribution factors for OERs are generally more appropriate for the allocation of funds among these post-secondary institutions.

We recommend that Congress clarify that regardless of whether post-secondary institutions may receive VEA funding for work-study and cooperative education programs, post-secondary institutions may be treated as OERs for purposes of funds distribution.

3. Relative Financial Ability

Relative financial ability (RFA) is the concept chosen by Congress to assure that LEAs and OERs with the least fiscal ability within a state receive a greater proportion of VEA funds.

The primary measure of RFA, local property wealth, has not been adequately defined to effectuate this goal. Federal administrative efforts to create and implement an operational definition of local property wealth have been riddled with inconsistencies. ED has been overly rigid in its definition of this measure. This rigidity failed to take into account data problems associated with ED's definition and the distortions of actual fiscal disparities its definition has created in some states. There appears to have been little recognition that the measure of relative financial ability needs to be appropriate to the education financing system of a particular state.

We identified four problems which have been created by this legal framework. First, the definition of RFA as interpreted by ED is overly rigid and inappropriate for use in all states. Second, it does not provide guidance with respect to the definition of RFA where the impact of local revenues on recipient expenditures is diminished. Third, it is unclear with respect to the treatment of post-secondary institutions which do not receive local funds. And fourth, it does not require recipient-specific data for measuring RFA.

a. Property wealth or tax rate definitions -- Although the general patterns of funding school districts are very similar, there are certain differences among states in sources of local revenues for school districts that should be taken into account in designing a measure of relative financial ability. For example, where school districts are partially funded from local income taxes, this local source is a legitimate component of a measure of relative financial ability. Moreover, states have developed their own definitions of relative financial ability for distribution of state aid to school districts. Many state definitions of local wealth take into account personal income available locally to pay property taxes, or take into account higher cost students by weighting the student count used to calculate local wealth per pupil by students requiring higher cost programs.

In our view, states have had substantial experience in the measurement of the local financial ability of school districts, and general school aid formulas in most states substantially equalizing for local financial ability -- as far as these aid formulas go. Consequently, we recommend that each state be permitted to use the same measure of relative financial ability as it uses in its general school aid formula, if it uses such a measure. This would remove ED from having to develop sufficient knowledge and expertise to determine how to measure this concept in each state.

b. Effect of tax and revenue limitations -- Another issue which has created problems for the interpretation of "relative financial ability" is how should this be defined when legal constraints are placed on the use of local tax sources. This is a problem that has arisen in recent years as a result of statutory or constitutional limitations being placed on local property tax rates, assessment levels or local revenue increases.

The argument has been made to ED that, as a result of such limitations, RFA should be ignored in VEA funds distribution. We agree with ED's interpretation that RFA should not be ignored in these situations. Tax limitations affecting local revenues do not necessarily eliminate local fiscal capacity as a determinant of school district expenditures. Tax limitations typically do not place low wealth school districts in a better relative position in comparison to wealthy districts than they were before such limitations; in other words, they generally leave unaffected relative differences among school districts in fiscal capacity. Even tax limitations that totally freeze the local property tax rate or local revenues or assessments do not eliminate the impact of past fiscal disparities on current and future expenditures of school districts. Consequently, tax limitations do not, in and of themselves, eliminate the effects of differing fiscal ability on school districts' expenditures.

We have concluded that the adoption of a tax limitation provision should not be the basis for dispensing with relative financial ability as a required fund distribution factor.

Another issue raised by tax limitations is whether a measure of RFA other than the local tax base per capita or per pupil of the recipient should be used when local tax revenues for education are constrained. ED, in one state we studied, permitted RFA to be measured by the state and local revenues per pupil of school districts, in lieu of property wealth per pupil, because of a state limitation on the use of the local tax base.

In our view, ED's result was correct, but for the reasons discussed above this result should not be based on the existence of a tax limitation provision. Rather, such a measure of RFA should be permitted only when local revenues make up a relatively small proportion of total state and local revenues. When only a small share of total school district revenues (when Federal funds from all sources are subtracted) come from local sources, it is reasonable to use total state-local revenues per pupil as a measure of the relative financial ability of school districts. Since the variation among districts within a state in state-local revenues per pupil is less than the variation in local property wealth per pupil, the major effect of using this alternative measure will be to permit states to distribute VEA funds more like a flat grant per pupil. This appears reasonable when a state has undertaken to fund a larger proportion of the cost of public schools.

We recommend that the alternative measure of RFA be permitted for those states in which local revenues make up less than 25% of the total revenues (less Federal funds) of school districts. We recommend that the same standard also be applied to other eligible recipients.

To clarify this we suggest the following definition of "financial ability":

> The term "financial ability" means the property wealth per capita or per student of local school districts and of other public agencies having a tax base or the total tax effort of the area served by these schools and agencies as that effort is a percentage of the income per capita of those within the taxing body, except that (1) a state may use the same measure of "financial ability" used in the general school aid formula of the state, if the state formula includes such a measure; and (2) in any state in which local revenues constitute less than 25 percentum of the total financial support from state and local sources of all public agencies which are of the same type, the state may define financial ability as the total revenues or expenditures for current operating purposes (less Federal) per capita or per student available to or expended by a public agency.

c. Post-secondary institutions with no local tax base -- Some post-secondary institutions offering vocational education receive no funds from local tax sources. Their revenues come primarily from state taxes and tuition. ED has struggled, without substantial success, to clarify how RFA should be applied to such institutions. At one point ED permitted states to ignore RFA; subsequently, RFA had to be included using either a composite property wealth measure, which makes little sense; or total state-local revenues, for which calculations were unclear. We recommend that RFA be retained for post-secondary institutions, including those receiving little or no local tax revenues, but that the measure of RFA be the institutions total revenues or expenditures for current operating purposes (less Federal funds per capita or per student) as set out in the above recommendations. This will help to ensure that the equalization objective of the 1976 amendment is carried out at the post-secondary level.

d. Recipient-specific data -- Finally, we recommend, with respect to RFA, that any measure of RFA be recipient-specific. In other words, the data used to calculate RFA should be for individual LEAs and OERs, not for broader areas. As discussed in Chapter 2 in connection with the EDA factor, measures that are for areas broader than individual recipients mask actual differences among recipients by averaging them. ED required some states to use a "per capita" rather than a "per pupil" measure of local property wealth, even when per capita data were not available for individual recipients. This distorted and underestimated actual differences among recipients in relative financial ability. We recommend that states be given the option of using either a per capita or per pupil measure of local financial ability, but that the legal framework require the measure to be recipient-specific, whichever measure is used.

4. Low-Income Families and Higher Cost Students

RFA is one of the two most important fund distribution factors for both LEAs and OERs. The other most important factor for LEAs is "low-income families or individuals within such agencies"; and for OERs it is "the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language."[7]

In our opinion, Congress chose wisely when it selected these factors as complements to RFA. Low-income is an accepted measure of the need for additional educational services, and also can be considered a proxy measure for the capacity of the local population to fund education. Title I of the ESEA (now Chapter 1 of the Education Consolidation and Improvement Act of 1981),[8] for example, has long used low-income to target aid to educationally disadvantaged students.

The statutory definition in the VEA of "low-income family or individual" which requires the use of latest available data from the Department of Commerce is, however, too restrictive to carry out congressional intent. Such low-income data either may not be available on an LEA basis or may be as much as ten years out of date. We recommend that the statute be amended to permit states to use the best, most current, available data for individual recipients on low-income, including counts of children from low-income families; for example:

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[7] Sec. 106(a)(B)(i) of the VEA; (20 U.S.C. 2306(a)(5)(B)(i)).

[8] Sec. 101 of Title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 2701) (as amended by Chapter 1 of the Education Consolidation and Improvement Act of 1981).

- Low-Income Family or Individual

  The term low-income "family or individual" means families, individuals, children or students who are determined to be low-income according to the best, most current, available data specific to an applicant or to the area it serves.

We found higher cost students served by OERs to be an appropriate indicator of need for additional VEA funds for OERs. OERs which are primarily post-secondary institutions often draw students from an undefined area, and area data on low-income, such as district data which is appropriate for LEAs, could be highly misleading when applied to OERs. Consequently, we conclude that for OERs the student population of the institution whose education imposes higher than average costs is an appropriate measure of the relative need for funds for vocational education.

ED failed to interpret how this fund distribution factor should be measured. This has allowed states to use inaccurate measures or mathematically eliminate the factor while appearing to use it. It also allows OERs to define it to suit their purposes. For example, although the statute refers to "students whom [OERs] serve whose education imposes higher than average costs," ED has not required an assurance or showing that such students receive higher cost programs. In addition, head counts of students at post-secondary institutions can be very illusive because of the variety of part-time enrollments; yet ED has not required student data that are comparable from institution to institution, e.g., by use of a full-time equivalency measure. Because pupil and fund accounting systems of post-secondary institutions vary more from state to state than those at the LEA level, we are not in a position to make a specific recommendation to address these problems, but would recommend that they be further reviewed.

II. VEA Recipients

A. Purpose and Organization

Section 106(a)(5)(B)(i) of the VEA distinguishes between local educational agencies (LEAs) and other eligible recipients (OERs) by requiring that different funds distribution factors be applied to these two categories of eligible recipients. "LEA" is specifically defined by statute as is "post-secondary educational institution", but significantly no definition exists in statute or regulation for OER. Moreover, the definition of LEA overlaps the definition of "post-secondary institution".

This section analyzes the relationship between these recipient categories and the funds distribution provisions.

B. Federal Legal Framework

Prior to 1976, the VEA was silent on the precise factors states must use to distribute funds to applicants and no distinction was made in the statute between local educational agencies and other eligible recipients. Indeed, the 1968 amendments which set out general factors to which states must give "due consideration" only referred to local education agencies in regard to the distribution of VEA funds.[9/] However, the definition of LEA was broad enough to include public post-secondary institutions:

[9/] Section 123(a)(6) of the VEA of 1963 as amended by P.L. 90-576 (20 U.S.C. 1263(a)(6)).

> The term 'local educational agency' means a board of education or other legally constituted local school authority having administrative control and direction of public elementary or secondary schools in a city, county, township, school district, or political subdivision in a State, or any other public educational institution or agency having administrative control and direction of a vocational education program.[10]

The concept of "any other public educational institution or agency having administrative control and direction of a vocational education program" appears to include any public post-secondary educational institution that provides vocational education.[11]

When the 1976 amendments distinguished between LEAs and OERs for funds distribution, they did not define OER, nor did they alter the existing definitions of LEA and post-secondary educational institution.

A major function of the broad definition of LEA appears to be to authorize post-secondary institutions to participate in work-study and cooperative education programs. ED has authorized states to consider post-secondary institutions as LEAs to qualify for work-study or cooperative education programs. Its interpretation, however, has changed over time as to whether a post-secondary institution designated an

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[10] Section 195(1) of the VEA (20 U.S.C. 2461(1)); formerly Section 108(a) of the VEA of 1963 as amended by P.L. 90-576.

[11] The statutory definition of "post-secondary educational institution" is:

> "a nonprofit institution legally authorized to provide postsecondary education within a State for persons sixteen years of age or older, who have graduated from or left elementary or secondary."

Section 195(12) of the VEA (20 U.S.C. 2461(1)); formerly Section 108(15) of the VEA of 1963 as amended by P.L. 90-516.

LEA for that purpose must also be considered an LEA for purposes of funds distribution.

ED originally gave states the option of treating such an LEA either as an LEA or OER for distribution of funds, with the recommendation that it be treated as an LEA where it has a local tax base or well-defined service area.[12] In contrast, the draft fund manual, which was circulated at the same time as the above interpretation, stated that when a post-secondary institution is designated as an LEA for participation in cooperative and work-study programs "the funding factors which apply to LEAs must be used in determining their funding for all programs."[13]

The same general interpretation appears in the November 1979 manual, but a caveat was added that post-secondary "LEAs" should be allowed "enough flexibility to meet their own specific conditions," which meant OER factors could be used when the post-secondary institution did not serve a particular local geographic area so as to "reflect the needs of the students within that institution."[14] This language was continued in ED's December, 1979 and July 1980 draft manuals.[15]

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[12] BOAE/DSVPO Policy Memorandum, FY 79-6, Sept. 19, 1979 at 8.

[13] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 8.

[14] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 9.

[15] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 9; and July 1980 at 12.

But the Draft Policy Memorandum which circulated during the same period appeared to contradict this, specifying that agencies which qualify as either an LEA or an OER must be consistently identified as an LEA or an OER during a given fiscal year for purposes of funds distribution and that the designation could only be changed for the following fiscal year.[16]

ED has taken the position that states which consider post-secondary institutions as LEA's for funds distribution purposes cannot classify the entire system of post-secondary institutions as a single LEA.[17] It does permit multi-campus institutions under the administration and control of a single _local_ administrative body to be considered a single LEA.[18]

Post-secondary institutions which are considered "other eligible recipients" (OER's) are to be treated as separate institutions for the funds distribution requirements, even when they are under the administration and control of a single state agency.[19] "They must, like other post-secondary institutions, compete individually for Federal funds..."[20]

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[16] BOAE/DSVPO Draft Policy Memorandum (Buzzell to State Directors of Vocational Education _re_: Criteria for Fund Distribution Procedure) (undated). At the very least, the above quoted language is ambiguous if it is intended to permit a post-secondary "LEA" to be considered an OER for funds distribution, but to require that whatever choice is made not be changed during the fiscal year.

[17] BOAE/DSVPO Policy Memorandum FY 80-4 (Jan. 7, 1980). This issue was also raised and answered in a consistent fashion several years earlier. _See_ BOAE/DSVPO Memorandum from Buzzell to State Directors for Vocational Education, Sept. 21, 1978.

[18] _Id_.

C. Policy Analysis, Conclusions and Recommendations

In our opinion there are good reasons for distinguishing for purposes of funds distribution between school districts and post-secondary institutions. And the LEA-OER dichotomy of the VEA is an apparent attempt to recognize these differences.

School districts generally serve students residing within a given area. And in most places the vast majority of students in grades 1 through 12 within the service area attend the public schools. Indeed, compulsory education laws mandate this, unless a private school option is chosen. In contrast, a post-secondary institution providing vocational education frequently serves an area whose boundaries are not precisely defined. It may be a community college provided by a community college district or an area vocational center drawing from several school districts.

However, because of the greater mobility of post-secondary students, students from other areas may attend. Or its vocational courses may be of interest primarily to students from only a part of the designated service area. And because of the greater variety of options (legally and practically) for persons who have graduated from high school (e.g., employment, college, military service, marriage), these institutions serve a smaller proportion of the total eligible population than do secondary schools. In addition, the eligible age span for post-secondary vocational education is generally from 16 through adult, without limit.

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[19] Id. ED explained that this is a necessary interpretation to ensure compliance with the legislative intent that "funds to be distributed to the maximum extent among post-secondary institutions."

[20] Id. This issue will be discussed more completely in the discussions concerning relative financial ability and higher cost student factors in this chapter.

Significant differences in funding patterns also exist between school districts and post-secondary institutions. For school districts, local and state tax sources provide most revenues, with tuition a relatively unimportant factor. And in many states local property taxes are the predominant revenue source. In contrast, post-secondary institutions frequently (but not always) rely more heavily on state subsidies, and tuition can be a significant revenue source. And some post-secondary institutions offering vocational education receive no local tax revenues, relying largely on state appropriations and tuition.

The distinction for fund distribution purposes between LEAs and OERs of section 106(a)(5) appears to reflect these differences between school districts and post-secondary institutions. We have found, however, two problems in the VEA legal structure in this regard. First "other eligible recipient" is not defined in the VEA. This has created an ambiguity about its relationship to the defined terms "LEA" and "post-secondary educational institutions." Second, the relationship between the requirement that post-secondary institutions be designated LEAs to be eligible for work study and cooperative program funds and the LEA-OER distinctions of the fund distribution provision has been unclear.

Of the four states in our research sample, three used "LEA" to designate only school districts. In these three states all post-secondary institutions, primarily community colleges, were considered "OERs" for funds distribution purposes. In the fourth state, community colleges were designated LEAs in order to qualify them for VEA funds for work-study and cooperative education. This state also uses the LEA fund distribution factors for community colleges; however, the LEA factors are applied separately for community colleges and school districts.

The overlapping and unclear definitions of "LEA", post-secondary institutions and "OER" do not appear to have created serious problems in the four states we reviewed. Neither did the interaction of the "LEA" requirement for cooperative education and work-study programs and the LEA-OER distinction for funds distribution. The fact that ED has vacillated in its interpretation of these issues indicates, however, that this may have been a problem elsewhere. Consequently, we recommend that these issues be clarified.

We concur with ED's interpretation that state-created post-secondary "LEAs" be treated as separate rather than single institutions. To permit otherwise would enable state institutions to receive Federal funds without regard for either of the funds distribution factors. This would place them outside the intent of the VEA distribution.

We also concur with ED's interpretation that locally administered and controlled multi-campus post-secondary institutions should be treated as one LEA. Their governance, program design and accounting systems are likely to parallel those of individual LEAs, which typically have more than one school and revenue sources and policies are typically the same for all campuses. This interpretation treats OERs in a manner that is consistent with the treatment of school distric

We recommend that Congress clarify that the designation of a post-secondary institution as an LEA to qualify for work-study and cooperative programs does not mean that the institution must be designated an LEA for funds distribution. The determination of how to treat such an institution for funds distribution should be based on the appropriateness of the LEA or OER fund distribution factors for the particular institutional system. In this regard we agree with ED's interpretation that if a post-secondary institution does not serve a particular local geographic area, it is appropriate to use the factor of higher cost students rather than an area measure of low-income persons "to reflect the needs of the students within the institution"[21/] -- irrespective of whether the post-secondary institution is designated as an LEA to qualify for work-study and cooperative programs.

Because of the wide variation in funding and service patterns of post-secondary institutions offering vocational education, we recommend that states be given the discretion to use either the LEA or the OER fund distribution factors to allocate funds to such institutions, so long as they use consistent designations within the same institutional system, e.g., among the community colleges within the state community college system or among area vocational centers.

[21/] BOAE/DSVPO Draft Information Manual for Federal Vocational Education State Grant Funds Distribution, July 1980 at 11.

III. LEA Fund Distribution Factor Provisions

A. Overview and Organization

As noted in Section I, the 1976 amendments included separate funds distribution factors for local education agencies (LEAs) and other eligible recipients (OERs). In this section we analyze each of the LEA fund distribution factors.[22]

The two most important factors to be used in distributing VEA funds to LEAs are:

1. "the relative financial ability of such agencies to provide the resources necessary to meet the needs for vocational education in the areas they serve"(RFA); and
2. "the relative number or concentration of low-income families or individuals within such agencies" (low income).[23]

This section is divided in three subsections. This first subsection provides an overview of the issues and a summary of our major findings, conclusions and recommendations. The second subsection examines the clarity, consistency and adequacy of the requirement that VEA funds be distributed on the basis of "relative financial ability" of recipients.

The third subsection explores the application of the low-income factor as the second factor for distributing funds among recipients.

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[22] Many of the issues pertaining to the LEA factor of relative financial ability (RFA) are common to the RFA factor for OERs. These common issues are considered in this section and not repeated in the section on OER factors.

[23] See 106(a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

Our major findings pertaining to the funds distribution factors for LEAs is that RFA and low-income have not been defined clearly or with sufficient flexibility and have been subject to inconsistent interpretation. The most troublesome issue for ED and the states has been what measures of these factors are legally acceptable. The statute does define "low-income family or individual"[24] but it does not define "relative financial ability." Definitions of both terms are found in the legislative history. These definitions have not, in all areas, been sufficiently clear or flexible to be applied without interpretation; and ED's interpretations of these terms have been at the same time sketchy, overly rigid and inconsistent.

In our opinion the fund distribution factors adopted by Congress in the 1976 VEA amendments are appropriate for implementing Congress' objective to equalize for the differing fiscal capacities of VEA recipients and to relate VEA funds to the needs of areas and students for vocational education. Unfortunately, the lack of clear and consistent interpretation of these fund distribution factors has undermined what is otherwise an adequate conceptual framework to guide the distribution of VEA funds. Consequently, it is important that the definitions and measures of relative financial ability and low-income students and families be clarified.

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[24] "The term 'low-income family or individual' means families or individuals who are determined to be low-income according to the latest available data from the Department of Commerce. Sec. 195(17) of the VEA of 1976 (20 U.S.C. 2461(17)).

B. Relative Financial Ability Factor

1. Overview of the Federal Framework and Organization of this Section

As noted in the introduction to this section, Congress amended the VEA in 1976 to clarify its intention that Federal funds be focused "on those school districts and other public agencies most in financial need of these funds."[25] The relative financial ability factor was intended to identify the most fiscally needy recipients so that VEA funds would be used within states to equalize for fiscal disparities among recipients.

The VEA legislative history sought to clarify the meaning of RFA, and the regulations issued by ED in 1977 relied on that history to provide operational definitions of this term. Consistent with the history ED required states to measure the relative financial ability of their recipients by property wealth per capita or by total tax effort per capita.

The purpose of this section is to analyze this RFA factor, as interpreted by ED, for its clarity, consistency and adequacy in carrying out congressional intent. Specifically, the section reviews the two measures of RFA that ED has permitted -- property wealth and the tax effort measures -- and makes policy recommendations as to each.

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[25] H.R. Rep. No. 94-1085 at 34.

We identified four issues which are raised by the RFA legal framework:

(1) Whether the property-wealth measure adopted by ED is comprehensive;

(2) What the effect of tax and revenue limitations should be on RFA;

(3) Whether the application of RFA to post-secondary institutions has resulted in a clear and consistent policy; and

(4) Whether ED's interpretation of the legal framework to require use of per capita rather than per pupil data is an adequate interpretation of Congress' intent.

Many of the basic issues raised and conclusions drawn are common to both LEAs and OERs; only issues particular to OERs will be discussed in the OER section.

2. Property Wealth Measure of RFA

a. Federal and state legal frameworks -- The House, in the 1976 Report, defined one measure of financial ability as "the property wealth per capita of local school districts and of other public agencies having a tax base...."[26] The regulations and draft policy manuals circulated by ED adopt this property wealth measure of RFA.[27]

ED has taken a firm position that property wealth is to be measured per capita rather than per student based on the use of the term "per capita" in the House Reports.[28] The term "per capita," however, also appears in the statute, section 106(a)(5)(B)(ii), which prohibits states from distributing VEA funding on a "per capita" basis; and in this section "per capita" has been interpreted by ED to mean "per student".[29]

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[26] H.R. Rep. No. 94-1085 at 34.

[27] Appendix A, 42 F.R. 53863. See, e.g., BOAE/DSVPO Draft Manual for Fund Distribution Procedures, Sept. 1979 at 7.

[28] See e.g., BOAE/DSVPO Suggested Procedures for Federal Distribution P.L. 94-482 (1979)(the first discussion manual).

In spite of its interpretation of section 106(a)(5)(B)(ii), ED appears to have felt constrained by the legislative history to prohibit a per student measure of local property wealth, except in "exceptional circumstances when per capita data are not available for local school districts."[30]

In fact, in many states current population data are not available on a school district basis. School districts are frequently not coterminous with census areas and when available, census data are frequently out of date. Most states, in their own formulas for distributing state general purpose aid to school districts, use a measure of local property wealth per pupil.

Three of the four states we reviewed use a per pupil measure of relative financial ability in their state aid statutes, and two of these three also use a per pupil measure of financial ability for distributing VEA funds. These two states apparently convinced ED that the "exceptional circumstances" for use of per pupil data existed.

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[29] Id. at 4.

[30] See Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 8; BOAE/DSVPO Draft Information Manual for Federal Fund Distribution Procedures, July 1980 at 12; and OVAE/DSVP Program Memorandum 81-5, Feb. 11, 1981 at 15. Initially ED announced that it would not accept any per pupil measures of property wealth for RFA. See, e.g., Suggested Procedures for Federal Fund Distribution 1979).

The third state, which uses a per capita wealth measure of RFA for VEA distribution, but a per pupil measure for state general aid, does not have current per capita data by school district. Thus, it is forced to use outdated census data. This state originally used a per pupil wealth measure for RFA, but was informed by BOAE that this was unacceptable.

The only other state of our four which uses a per capita property wealth measure considers all school districts in the same county to have the same property wealth per capita as the county average. It must do this, even though this flattens out much of the variation in wealth among districts within each county because current per capita data are not available by school district.

ED, in written interpretations, has required states to "determine financial ability of eligible recipients and allocation of Federal VEA funds without considering any allocations of supplemental funds such as state aid given through equalization formulas which guarantee each recipient a minimum funding level." [31] This appears to be based on the definition of RFA in the House Report which is "the property wealth per capita of local school districts and of other public agencies having a tax base".[32] It is designed to prevent a state from reducing the equalizing potential of the RFA factor by, for example, calculating RFA as the amount of a guaranteed tax base per pupil built into an equalization formula; such a calculation would reduce the range of disparities among LEAs shown by the RFA measure.

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[31] Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 7. The original interpretation of this issue apparently came from a BOAE Policy Directive. See BOAE Memorandum from Buzzell to Assistant Regional Commissioners Re: Policy Directive Relating to Fund Distribution(Feb.8,1978). See also DSVPO Program Memorandum 81-5,Feb. 11,1981 at 4.

ED has had to reconcile the interpretation of RFA with arguments by states that as a result of state imposed limitations on local revenues, RFA should either be ignored or measured other than by local property wealth. ED rejected the argument that RFA be ignored when state restrictions are placed on the local tax bases. It did, however, permit one state we reviewed to use a measure of RFA which included the amount of state aid funds each LEA received. This state has imposed stringent legal limitations on local property assessment levels and tax ratios. In response the state had picked up a much larger share of school district costs from state revenues. The state argued to ED that a property wealth measure of RFA was no longer appropriate because school districts have little power to use their local tax bases to increase expenditures. ED permitted the state to use as the measure of RFA the revenue limits imposed on school districts by the state aid system enacted after this tax limitation was enacted. This revenue limit included state and local revenue per pupil for current operating purposes. In effect, ED permitted this state to substitute a measure of revenue disparity among LEAs for a measure of fiscal capacity.

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[32] BOAE issued a Policy Memorandum on this issue in 1979. BOAE/DSVPO Policy Memorandum FY 79-4 Re: Effect of Property Tax Limitation (Proposition 13 Type) on the VEA Fund Distribution Procedures. In the memo BOAE concluded that "the levy limitation impacts primarily on the tax rate, with the tax base remaining relatively constant" and that although it "may have the effect of reducing funds available for education. . .[it] should not alter the relative standing of those districts which have the least native financial ability. . . ."

Another state has a dual measure of RFA, one of which includes the required property wealth per pupil factor and a second RFA factor of state school aid per pupil. The factors are related so as to cancel each other out. This is because districts with small amounts of property wealth per pupil receive larger amounts of state aid per pupil. The combining of these two factors as an RFA measure renders RFA meaningless.

None of the states we reviewed used a tax effort measure for RFA, and another study indicates that this measure is seldom used by states.[33]

b. Policy analysis, conclusions and recommendations -- Relative financial ability is the concept chosen by Congress to ensure that LEAs and OERs with the least fiscal ability within a state receive a greater proportion of VEA funds. It is a concept which is well-accepted as a basis for allocation of funds among school districts because local property wealth is a major determinant in most states of the financial resources available to districts. Although the objectives and intentions behind the RFA factor are clear, the primary measure of RFA, local property wealth, has not been adequately defined to ensure that these are carried out.

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[33] Benson and Hoachlander, The Distribution of Federal Funds Under the Vocational Education Act: Interstate and Intrastate Allocation (Berkeley, California, 1981).

The statute lacks a definition of RFA, and Federal administrative efforts to create and implement an operational definition of local property wealth have been inconsistent and overly rigid and have distorted and minimized the fiscal equalization intended by the 1976 amendments.

ED has been overly rigid in requiring that a *per capita* measure of local property wealth be used, except when states have been able to convince ED that "exceptional circumstances" for using a *per pupil* measure were present.[34] The requirement of per capita property wealth measure failed to take into account that census data are often outdated and that many states do not have per capita data on school districts, which often overlap census units. Requiring that RFA be measured by per capita property wealth in this situation means that the state either must use outdated population data or must calculate the per capita property wealth for a larger area and apply that value to all LEAs in that area. This means the data are old, or the wealth variation is minimized by averaging the variation among individual LEAs, or both. This has the effect of distorting and minimizing the variation in relative financial ability for which Congress intended VEA funds to compensate.

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[34] The definition in the House Report which refers to "per capita" contributed to this; however, the "per capita" language in section 106(a)(5)(B)(ii) has been interpreted to mean "per pupil." Thus, it is not clear that Congress intended to preclude the use of per pupil measure of wealth by its reference to "per capita."

Where both per capita and per pupil data are available on a school district basis, the choice of measure can have an impact on the distribution of funds among LEAs. In general, a per capita measure will provide greater funds to school districts which have a smaller percentage of their population in public schools. Frequently this benefits LEAs with older populations, e.g., many central cities and older suburbs.

We recommend that states, under the VEA, be given the option of using either a per pupil or per capita measure of property wealth for RFA. Most states have data on property wealth per pupil. Thus, if a single measure were to be required this would be the logical choice; however some states have per capita data on school districts and use this to measure wealth for distribution of state aid to education, in large part to direct additional state funds to central cities. If such a state wished to use a per capita RFA measure we see no reason, in light of the equalization objectives of the RFA measure, to prohibit this.

States have had substantial experience in the measurement of the local financial ability of school districts. All but a few states take the fiscal capacity of school districts into account in distributing state aid. Even where state aid systems have been successfully challenged in the courts because of inequalities or inadequacies, it has usually not been because of deficiencies in the measure of local wealth, but rather because of the failure to compensate adequately for differences in school district fiscal capacity as so measured.

Although the general patterns of funding school districts are very similar, there are certain differences among states in sources of local revenues for school districts that should be taken into account in a measure of relative financial ability. For example, where school districts are partially funded from local income taxes, this local source is a legitimate component of a measure of relative financial ability, and where this occurs the state's measure of local wealth typically includes both personal income and property wealth.

In addition, many states have sought to compensate in their state aid formulas for the higher costs of educating certain children or providing certain programs where these costs or programs are not uniformly present and needed in all school districts. Frequently this compensation is made by weighting the number of students attending or enrolled in school by certain factors for higher cost students or programs. Some states weight each handicapping condition or type of service by a numerical weight, e.g., an educable mentally retarded student may receive a weight of 3 (meaning that student counts as 3 students) to reflect the higher costs of educating that student. When a weighted student count is used to calculate the property wealth per pupil of each school district, districts with a greater proportion of weighted pupils are determined to have proportionately less property wealth per weighted pupil. As a result, the school district is determined to have less local fiscal ability and receives more state aid than if a weighted pupil count were not used. The pupil weightings that states use in their own aid to education programs are generally consistent with congressional intent under the VEA to provide greater resources to LEAs with reduced fiscal capacity and greater student needs for vocational education.

Based on the considerations just described, we recommend that each state be permitted to use the same measure of relative financial ability as used in its general school aid formula, assuming it uses such a measure. In our opinion, this would better ensure that the RFA measure is appropriate to the educational financing structure of each state. It would also remove ED from the minutiae of how to measure this concept in each state, which has been a source of continuous and frequently unproductive controversy between ED and the states.

We also recommend that Congress clarify when state and local revenues or expenditures per student can be used as a proxy for relative financial ability. This issue has arisen in recent years as a result of statutory or constitutional limitations being placed on local property tax rates, assessment levels or local revenue increase.

These limitations have taken several different forms. In some states the level of assessment of real and personal property for property tax purposes has been frozen or rolled back, and limitations have been placed on future increases. In other states the tax rates on local property have been restricted or frozen. A third type limits the amount of revenues raised from local property taxes.[35] Interestingly, similar provisions restricting the availability of local revenues have long been in place in many states.[36]

Based on the most recent enactments of these limitations in certain states, the argument has been made to ED that RFA should be ignored in VEA funds distribution. ED, interpreting the VEA correctly in our view, concluded that RFA should not be ignored in these situations.

ED's basis for this interpretation appears to have been that it did not have the power under the statute to waive the RFA requirement. We have concluded that ED's interpretation also best carries out the intent of Congress in the 1976 amendments to equalize for disparate local fiscal abilities among school districts within a state.

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[35] For an overview of the different types of limitations, see Education Commission of the States, School District Expenditure and Tax Controls (Denver, Colorado; 1978).

[36] For a state-by-state review of such limitations, see Id. at 31-55.

Tax limitations affecting local revenues do not necessarily eliminate local fiscal capacity as a determinant of school district expenditures; nor do they necessarily place low wealth school districts in a better position in comparison to wealthy districts than they were before such limitations. In other words, they can leave unaffected relative differences among school districts in fiscal capacity.

Even tax limitations that totally freeze the local property tax rate or local revenues or assessments do not eliminate the impact of past fiscal disparities on current and future expenditures of school districts. Tax and revenue limitations on school districts may, as a practical matter, place a greater burden on the state to fund future increases in educational expenditures or to make up for lost revenues. But it is not pre-ordained that the state's response in this situation will be directed toward minimizing the effects on expenditures of differences in the size of school district tax bases. This will depend both on the size of the respective local and state shares of educational expenditures in the state, and how the state share is distributed, e.g., whether it is directed to eliminating expenditure differences resulting from disparate local tax bases.

For example, our review of the changes in the financing system made in one state after local revenues were limited indicated that most new state funds for school districts were put into hold-harmless provisions and flat grants which reinforced the differences in expenditures among school districts that existed prior to the tax limitations. Local tax and revenue limitations do not, in and of themselves, eliminate the effects of differing fiscal ability on school districts expenditures. Consequently, we conclude that the adoption of a tax limitation provision should not be the basis for eliminating relative financial ability as a required fund distribution factor.

Another issue raised by tax and revenue limitations is whether a measure of RFA, other than the local tax base of the recipient per capita or per pupil, should be used when local tax revenues for education are constrained. After legal constraints had been placed on the use of the local tax base, ED permitted one state to calculate school district RFA by a measure of state-local revenues. In our opinion, ED created an appropriate exception to its general policy, 37/ but did not clearly articulate its policy rationale.

In our view, this result should not be based simply on the existence of a tax and revenue limitation provision. Rather, it is our conclusion that such a measure of RFA should be permitted only when local revenues make up a relative small proportion of total state and local revenues.

37/ The general policy is described in BOAE/DSVPO Policy Memorandum, FY 79-4 (undated).

The basis for this conclusion is, as described above, that local tax and revenue limitations do not by themselves eliminate school district taxable wealth as a determinant of expenditures. Differences in local taxable wealth have had a substantial impact on expenditures in states which have had similar tax and revenue limitations as a feature of their laws for many years. These limitations come in too many forms and their apparent constraints are often mitigated by exceptions, e.g., it may be possible to override them by local voter referendum. And, statutory limitations may be modified by the state legislature.

A state legislature's response to a tax or revenue limitation is typically more important than the limitation in determining the effects of tax bases on school district expenditures. Where restrictions on local bases have been sufficiently severe, states have had to increase substantially the amounts of state funds for such recipients. Thus, many of the same issues, relating to the distribution of state and locally provided funds to recipients, remain after such limitations are adopted: what proportion of total state and local funding for school districts and postsecondary institutions is provided by the state and how equalizing is the distribution of state funds.

When the state share of educational funding is sufficiently large and that share is distributed so as to equalize for disparate local district fiscal ability, it is likely that the effects of disparate local tax bases on expenditures will be substantially reduced.[38] It is our conclusion that in this situation it is appropriate to measure relative financial ability by the amount of state and local revenues per pupil available to a school district. Here only a small share of total school district revenuew (less Federal funds from all sources) is derived from local sources; thus, it is reasonable to look to other measures of RFA for VEA funds distribution.

It is important to note that the major effect of using state-local revenues per pupil as a measure of RFA is to reduce the variation in VEA funding among LEAs resulting from the use of the RFA factor. This occurs because, as a general rule, the variation among school districts within a state in state-local revenues per pupil is less than the variation in local property wealth per pupil.

This recommendation would permit states which have assumed a higher proportion of the cost of education in the state to distribute VEA funds more like a flat grant per pupil.[39]

We recommend that this alternate measure of RFA be permitted for these states in which local revenues make up less than 25 percent of the total state-local revenues of school districts. We recommend that the same standard also be applied to other eligible recipients. Although as noted the percent of local funding and the manner in which state aid is distributed both play a part in determining whether the local tax base substantially determines expenditures, we recommend that a simple test using only the percentage of local funds be used. First, this test has the benefit of easy administration. Second, measurement of the characteristics and effects of formulas providing general state aid to school districts can be a fairly involved undertaking. And third, at this level of local funding there can be little disagreement that that the impact of local funding has been diminished.[40]

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[38] Depending on the state financing system used, the ability or willingness to levy local taxes may still cause differences in the level of funding among school districts.

[39] This discussion of the effects of using one RFA measure or another assumes that the conclusions and recommendations concerning the use of these funds distribution factors made in chapter 4 are adopted. Absent the chapter 4 recommendations, the effects of the funds distribution factors cannot be predicted, which is the same situation as under present interpretations of the VEA.

To authorize this alternative measure of RFA, we suggest the following definition of "financial ability":

> The term "financial ability" means the property wealth per capita or per student of local school districts and of other public agencies having a tax base or the total tax effort of the area served by these schools and agencies as that effort is a percentage of the income per capita of those within the taxing body, except that (1) a state may use the same measure of "financial ability" used in the general school aid formula of the state, if the state formula includes such a measure; and (2) in any state in which local revenues constitute less than 25 percentum of the total financial support from state and local sources of all public agencies which are of the same type, the state may define financial ability as the total revenues or expenditures for current operating purposes (less federal) per capita or per student available to or expended by a public agency.

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[40] We would concede that depending on the state aid system, local funding might still have free reign within this narrower scope. This certainly militates against abolishing the RFA factor. We are less concerned about this, however, when the issue is a state's option to use an alternative measure of RFA.

3. Tax Effort Measure of Relative Financial Ability

The House report and the regulations also define "financial ability" as the "total tax effort of the area served by these schools and agencies as that effort is a percentage of the income per capita of those within the taxing body".[41]

ED initially discouraged the use of tax effort as a measure of relative financial ability on the ground that tax effort is difficult to determine for an LEA or an area served by an eligible recipient. ED noted that it is often very difficult to determine how much of the industry-wide taxes would accrue to a particular LEA or OER. (Here, ED did not appear to distinguish between local and state taxes.) Consequently, ED urged states to use property wealth per capita.[42] Commencing in November of 1979, ED's policy appears to have shifted from active discouragement to toleration of tax effort measures.[43] It has not offered further clarification of the concept.

Although the measure is effort as a percentage of income per capita of those within the taxing body, it is unclear what taxes figure into this percentage. For example, it is not clear whether this is to include only taxes for public education or for all units of government, or whether only local taxes or both local and state taxes are to be included.

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[41] H.R. Rep. No. 94-1085 at 34; Appendix A, 42 FR 53864 (Oct.3,1977).

[42] BOAE/OVAE Suggested Procedures for Federal Fund Distribution P.L. 94-482 (1979) at 1. See also the Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June, 1979 at 7.

[43] See, e.g., BOAE/OVAE Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 6.

Even assuming it were clear what taxes should be included, there would still be serious data problems in many states. Accurate per capita income data typically are not available for LEAs where LEAs overlap other local jurisdictional boundaries. For the same reason data on total local tax effort are often not available by school district.

Because the tax effort RFA measure is virtually ignored by the states, we have not devoted much attention to it other than to note the above problems; and we make no recommendation about whether it should be continued.

C. Low Income Factor

1. Purpose and Organization

In addition to relative financial ability, the other most important factor for distributing funds to LEAs is the "relative number or concentration of low-income families or individuals within such agencies". Section 106(a)(5)(B)(i). The 1976 House amendments included this factor for the same reason as RFA: "it readily identifies those agencies most in need of this assistance".[44] Thus, the low-income factor is a proxy measurement of need for vocational education which provides additional VEA funds to LEAs with disproportionate concentration of low-income persons.

We have identified two issues regarding the clarity of the low-income factor: (1) what data may be used to measure the low-income factor, and (2) what is the meaning of "relative number or concentration"?

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[44] H.R. Rep. No. 94-1085 at 34.

2. Acceptable Data Sources

a. Federal and state legal frameworks -- The term "low-income family or individual" is defined by the VEA as "such families or individuals who are determined to be low-income according to the latest available data from the Department of Commerce."[45]

As noted by ED itself, this statutory definition created problems because Department of Commerce data may be up to 10 years old, and may not be available on an LEA basis.[46]

As a result of these problems ED first recommended that states construct their own updates or use acceptable proxies.[47] And some of ED's draft manuals on funds distribution provided examples of proxy data:[48]

> (a) The relative number or concentration of low-income families/individuals within the agency which are below a state-defined poverty level.
>
> (b) The relative number or concentration of low-income families/individuals who have been designated as economically disadvantaged by the State.
>
> (c) Aid to Families with Dependent Children (AFDC) data.
>
> (d) Title I student count data.
>
> (e) School Lunch Program recipient data.

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[45] Sec. 195(17) of the VEA (20 U.S.C. 2461(17)).

[46] See Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 7.

[47] Id.

[48] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 8. BOAE/DSVPO Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Procedures, July, 1980 at 11.

ED's standard for the use of proxy data was that it must be the "latest and most reliable data on low-income families or individuals."[49]

ED's most recent pronouncement is less permissive about proxy data. It points out that Department of Commerce data is required by statute. While recognizing that this data may not exist for LEAs or cannot be meaningfully applied, it encourages states to contact ED for technical assistance - rather than authorizing state discretion to use proxies. ED does state that "in these cases it may prove necessary to permit use of. . .[other] sources of data".[50]

During the time that ED was specifically authorizing states to use proxies, it was also recommending that counts of low-income children or students not be used if at all possible.[51]

As stated in one ED report, child-student data were objectionable because it is the intent of the law to base funding on the needs of the community supporting the program and not on the needs of the school age population alone; and that this factor would ignore the number of adults who want to update their occupational skills as well as variations from one district to another in the proportion of school to total population. ED specifically criticized use of AFDC and Title I student counts as too limiting because of the possible undercounting of families/individuals not applying for AFDC benefits.[52]

49/OVAE/DSVP Program Memorandum FY 81-5, Feb. 11, 1981.

50/*Id*.

51/BOAE/DSVP Draft Manual for Federal Fund Distribution Procedures Sept.1979 at 5.

52/Final Report DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 6-7.

A later draft funds distribution manual was less categorical.[53] Although it repeated most of the objections to child-student counts appearing in earlier reports, it also indicated that "it may be advisable to use student data as part of the aggregate to indicate low-income families/individuals, as long as the total population counted includes adults".[54] How student and family/individual data on low-income were to be combined in this situation was not made clear. Later draft handbooks and DSVP Program Memorandum 81-5, however, have listed AFDC, Title I and school lunch data as permissive proxies.[55]

Currently, only one of our four states uses Department of Commerce data on low-income families or individuals. The other three use proxies, such as AFDC, Title I or state low-income data. In each instance, they had the burden of demonstrating why these data were preferable to Commerce Department data, e.g., one state had to demonstrate the correlation between AFDC and Department of Commerce data.

In the two states which use AFDC and Title I low-income student data, the low-income factor can be calculated directly for particular LEAs since these data are available by LEA.

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[53] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedurees, Sept. 1979 at 7.

[54] Id.

[55] ED has specifically disapproved certain proxies. These include total taxable income, per capita income, local personal income per pupil or per total population. ED considered these to be indicative of financial ability rather than the number or concentration of low-income families. Unemployment data were also rejected as a proxy because this was said to be an indicator of economic depression rather than necessarily a measure of low-income families. Final Report, DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 6-7.

The states which use Department of Commerce and state collected low-income data only have such data by county and not by LEA. Consequently, in these states all LEAs within a county are assigned the same low-income factor irrespective of whether proportions differ within counties.

b. Policy analysis, conclusions and recommendations --

Low-income is an accepted measure of the need for additional educational services, and also can be considered a proxy measure for the capacity of the local population to fund education. Title I of the ESEA (now Chapter 1 of the Education Consolidation and Improvement Act of 1981), for example, has long used low-income to target aid to educationally disadvantaged students.[56]

The statutory definition of "low-income families or individuals" refers to a determination based on data from the Department of Commerce. Unfortunately, these data, because they are frequently out of date and not available on an LEA basis, have serious flaws when used to measure the number or concentration of low-income persons within school districts.

Legitimate state pressure resulted in ED's recognition that proxy data may be more current and accurate. ED's policy in this regard, however, has been neither clear nor consistent concerning acceptable proxies. For example, it first advised against the use of data on low-income children or students and then permitted it.

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[56] Sec. 101 of Title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 2701)(as amended by Chapter 1 of the Education Consolidation and Improvement Act of 1981).

We have concluded that Department of Commerce data on low-income families or individuals are inappropriate for use as the low-income measure in many states. First, these data typically are not available by LEA. This means that data for larger units such as counties have to be used. Low-income persons may be highly concentrated in a few LEAs within the county. Yet this fact is masked by the use of county data and results in providing funds based on the low-income factor to LEAs that should not qualify for them. Second, Commerce data comes from the decennial census. This is only updated between census counts in areas with large population concentrations, and these estimates are not made by school district. These data can be as much as ten years out of date.

Consequently, we recommend that the statutory definition of "low income families or individuals" be amended to delete all reference to Department of Commerce data. Further, we recommend that states be permitted to use the best available data specific to an applicant or to the area it serves. This would make clear that low-income data for units larger than a single LEA are invalid measures of the need for vocational education in a particular LEA, and should not be used.

Since in many states low-income data are not available by LEA for the general population, low-income data on students enrolled in the LEA frequently will have to be used -- as it has long been under Title I of the ESEA (now Chapter 1 of the Education Consolidation and Improvement Act of 1981).[57/]

[57/] *Id.*

It is our conclusion that, for LEAs, student data on low-income are often a better reflection of the need for vocational education at the secondary school level than data for the total population of the area. LEAs predominantly provide vocational education to non-adult students who are enrolled in a full-time secondary school program. In addition, the student bodies, particularly in cities, often reflect a lower income composition than the general population. In these situations the use of low-income data for the total population would underestimate the actual concentration of students from low-income families being served by the LEA. Consequently, we recommend that the statutory definition of low-income family or individuals be amended to include children and students.

To incorporate the recommendations made above, we recommend that the definition of "low-income family or individual" be amended to read:

> Low-income Family or Individual
>
> The term "low income family or individual" means families, individuals, children or students who are determined to be low-income according to the best available data specific to an applicant for funds under this Title, or to the area it serves.

3. Relative Number or Concentration

   a. Federal and State Legal Frameworks

The VEA describes the low-income factor as being measured by the "relative number or concentration of low-income families or individuals..."[58] Both the statute and legislative history are silent as to the meaning of the underlined phrase. But ED has consistently interpreted it to refer to the relative occurrence and concentration of low-income persons rather than absolute numbers.[59]

The statutory language does not clearly define whether a recipient's proportion of low-income persons is calculated as a proportion of the recipient's total population (families, individuals or students) or as a proportion of the total number of low-income persons in the state. ED has resolved this in favor of the former interpretation. It has consistently stated that "relative number and concentration" are synonymous and mean "that portion of the population within the LEA."[60]

ED has also interpreted the low-income factor to require a count of families or persons below some accepted poverty threshold, and has not permitted the use of average or median family or per capita income.[61]

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[58] Sec. 106(a)(5)(B)(i) of the VEA of 1976 (20 U.S.C. 2306(a)(5)(B)(i)).

[59] *See, e.g.*, Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures June, 1979 at 6.

[60] *See, e.g.*, Notice of Interpretation 45 F.R. 81813 (Dec.12, 1980) at 81814. The only policy paper which interpreted this phrase to require a proportion of the State's low-income population was the Final Report of the DSVPO Task Force on Federal Funds Distribution Procedures, June 1979 at 6. This interpretation was switched to the proportion within an LEA in the subsequent policy manual. BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 5. A later draft information manual permits states to include a comparison of the concentration within an LEA to the concentration within the state "as an indication of each LEA's relative standing. . ." BOAE/DSVPO Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Procedures, July 1980 at 10.

[61] *See, e.g.*, BOAE/DSVPO, Pennsylvania State Plan Deficiencies as a Result of Management Evaluation Review for Compliance/Quality, June 20, 1979 at 1-2.

The first funds distribution formula adopted by several states in response to the 1976 amendments measured the low-income factor by the absolute number of low-income persons. ED found these low-income factors to be out of compliance, and currently all use a proportional calculation. One state, however, still determines a recipient's low-income proportion as that recipient's proportion of the total number of low-income persons in the state despite ED's clear position to the contrary. A second state was recently challenged on this same matter, and changed its measure as a result.

b. Policy analysis, conclusions and recommendations -- We have concluded that ED has correctly interpreted the low-income factor to require a count of families or persons below some accepted poverty threshhold. The statutory definition is clear that the measure must be based on a "relative number or concentration of low-income families or individuals." Median family income or per capita income data do not permit one to determine the "number or concentration" of families or individuals. Per capita income data are averages which can mask great differences in concentrations of revenue at different levels of income. One community may have high concentrations of both poor and rich persons; another may have only middle income persons; yet both may have the same per capita income. Similarly, median family income only gives the income which half the population is above and below -- again, providing little information on income concentrations.

With respect to ED's interpretation that "number or concentration" refers to the proportion of low-income to total population of a particular recipient, we have concluded that, in general, this is consistent with the intent of Congress. Problems have arisen from this interpretation, not because it is incorrect or illogical, but because of its interaction with an erroneous ED interpretation concerning the interaction of funds distribution factors.

We term ED's erroneous interpretation the "service unit fallacy".[62] The service unit fallacy is ED's urging (in some cases requiring) states to eliminate the number of pupils to be served with VEA funds (or other service unit) from state formulas for distribution of VEA funds. As discussed in later chapters, funds distribution formulas have irrational distributional effects when pupils or other measures of recipient size are eliminated as multipliers in the formula. For example, where the number of students in each LEA is not used as a formula multiplier, two LEAs that have vastly different enrollments may qualify for the same total amount of VEA funds - if they have the same scores on the formula factors, e.g., low-income and RFA. Where no recipient size multiplier is used in the formula, the use of a percentage concentration measure of low-income persons contributes to the irrational result described above. In this case a low-income measure that used absolute number of low-income persons in the LEA, or the proportion of low-income persons in the state that resides in the LEA, would have the effect of giving some weight to the size of the LEA.

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[62] The service unit fallacy is discussed at greater length in Chapter 4.

The problem here, however, is not ED's interpretation of the low-income factor, but rather its lack of clarity concerning the use of pupils or other recipient size indicators in formulas. For example, where a pupil multiplier is correctly used, ED's proportional measure of low-income persons results in each

LEA with the same proportion of low-income persons (to total LEA population) being treated alike on a per pupil basis -- a fair method of allocation.

Thus, incorporation of the recommendations concerning requiring a recipient size measure in VEA funds distribution formulas would ensure that ED's correct interpretation of "relative number or proportion" does not have an unintended distorting effect on the distribution of VEA funds.[63]

IV. OER Fund Distribution Factor Provisions

A. Overview and Organization

Under the VEA, separate funds distribution factors must be applied to "Other Eligible Recipients".[64] These factors are:

> 1. "the relative financial ability of such recipients to provide the resources necessary to initiate or maintain vocational education programs to meet the needs of their students"; and
>
> 2. "the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language."[65]

The relative financial ability factor for OERs is similar to that for LEAs, and certain issues, such as appropriate data sources for property wealth, are common to both factors. The same is true of the term "relative number or concentration" which also appears in the LEA low-income factor. Discussion of these common issues, treated in the previous section on LEA factors is not repeated here.

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[63] See Chapter 4 for further discussion of the recommendation on recipient size measures.

[64] As described in section 2, most OERs are post-secondary institutions such as community colleges; however, in some states post-secondary institutions are considered LEAs to qualify them for VEA work-study and cooperative education programs.

[65] Section 106(a)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

This section focuses on issues specific to OERs and identifies needed clarification or modification in the OER RFA and higher cost students factors.

We identified several problems which prevent the RFA and higher cost student factors for OERs from operating consistently to accomplish congressional objectives respecting the distribution of VEA funds among recipients.

First, state funding systems for post-secondary institutions are often very different than those used for school districts, and the concept of RFA has not been consistently interpreted to take into account state methods for funding post-secondary institutions. ED has provided inadequate guidance concerning the measurement of RFA of such institutions, both with respect to the tax base or revenue measure and the use of a per pupil or per capita basis for comparing institutions.

Second, the OER factor of higher cost students was also weakened by ambiguity about methods of counting students and the lack of any necessary relation between students counted as "higher cost students" and the level of services provided to such students.

B. Relative Financial Ability

1. Federal and State Legal Frameworks

Relative financial ability is required to be one of the two most important factors for funding OERs. The regulations state:

> "in the case of OERs, the relative financial ability of such recipients to provide the resources necessary to initiate or maintain the vocational educational programs to meet the needs of their students. . . [66]

The same general definition of "financial ability" in the regulations applies to OERs and LEAs. For both there is the option of measuring RFA by property wealth per capita or total tax effort of the area as a percentage of income.[67] The regulations specifically state that the property wealth per capita measure applies to both "local school districts and. . . other public agencies having a tax base".[68] Whether the regulation means what it says is unclear. ED's most recent program memorandum on funds distribution requires OERs to use the LEA measure of property wealth per pupil "if an OER chooses to be considered as an LEA in order to use Federal funds for cooperative education and work-study programs and has its own taxing authority."[69] This leaves open the issue of how to treat OERs that have local tax bases, but do not choose to be treated as LEAs to qualify for cooperative education and work-study programs.

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[66] 42 F.R. §104.141(f)(5)(B)(i)(II). (Quoting from the statutory language of Sec. 106(a)(5)(B)(ii) of the VEA (20 U.S.C. §2306 (a)(5)(B)(ii)).

[67] 42 F.R. 53864 (Oct. 3, 1977).

[68] Id.

[69] OVAE/DSVPO Program Memorandum FY 81-5 (Feb. 11, 1981) at 7.

Where OERs do not have a tax base, ED has not required states to use the "total tax effort of the area" option for measuring RFA. Rather, ED has authorized several other options. States first were permitted to dispense with the property wealth per capita measure for RFA where the state "provides full financial support for other eligible recipients, either by funding 100 percent of an approval budget or by providing a uniform level of support."[70] ED's most recent interpretation on this issue no longer refers to the state providing "full financial support," nor does it appear to require that the OER have no tax base. Instead, the criteria are now stated as "where an OER receives no local funds or receives a uniform level of support from the state."[71]

Originally, Federal administrators authorized states that met the criterion to use one of two options for relative financial ability:[72]

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[70] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June, 1979 at 8. See also, BOAE/DSVPO Policy Memorandum, FY 79-6, Sept. 1979 at 8.

[71] OVAE/DSVPO Program Memorandum FY 81-5, Feb. 11, 1981 at 6.

> (1) it could consider the institution which receives the largest amount of state funds as the one with the highest ability to pay, or
>
> (2) it could assign the same weight to all OERs for the RFA measure, in which case RFA is inoperative.

Within the same year, BOAE added a third option: OERs meeting the criterion could "define the service area of each OER as clearly as possible and use a composite of relative financial ability computed for each LEA with the service area."[73]

In its latest interpretation, ED reduced the options to two, eliminating the option of making RFA inoperative.[74] ED eliminated this option on the ground that it did not have the authority to ignore a factor required by statute.[75]

Post secondary institutions receiving VEA funds in our four study states reflected two different patterns of state support. In two states these institutions, primary community colleges, were supported from a combination of local and state tax revenues and student tuition.[76] In the other two states local revenues were not used, with primary funding coming from state revenues and tuition. In one state these were state funded community colleges; in the other state, these were state funded technical schools. The RFA measures used by the states, which ED approved, could not always be predicted, however, from the interpretations of RFA described above.

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[72] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 9. The Task Force Report noted that the first method "does not take into account different size institutions/programs or the fact that different institutions will be fully funded at different amounts. It is not an accurate indication of need". The second method was found to "yield the most accurate expression of need" and was the "recommended" method. See also BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 9.

[73] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 10, and Dec. 1979 at 10. See also Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Manual. July 1980 at 13.

[74] OVAE/DSVPO Program Memo. 81-5, Feb. 11, 1981 at 6.

[75] Id.

[76] One of these states treats post-secondary institutions as LEAs to enable them to participate in work-study and cooperative programs.

One of the states, in which OERs receive local tax revenues, originally used a measure for RFA of state appropriations to each OER per FTE student and the annual percent increase in tuition cost at each OER. ED found these measures invalid apparently because it concluded they did not give a true indication of "an institution's ability to pay."

Subsequently, with ED's approval, RFA was measured by net revenues, endowments and gifts per FTE student (net revenues excludes both state and Federal revenues). This RFA measure is inversely scaled so that OERs with the greatest net [local] revenues receive the fewest VEA funds.

The other state whose community colleges receive local funding originally used state apportionment and local tax revenues per FTE students in average daily attendance. Subsequently, the state went to a property wealth per pupil measure of RFA for its post-secondary "LEAs."[77] Then, following the enactment of a local tax limitation which resulted in an infusion of additional state aid to community colleges, the RFA measure was changed to the state-local revenues limit per pupil imposed on each institution by the state's financing program for these institutions. This measure was accepted by ED.

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[77] Although the state considers these institutions LEAs, they are ranked separately from school districts. In addition this state used a state local revenue measure of RFA for community colleges before it used a similar measure for school districts. School district LEAs used a property wealth per pupil measure of RFA at that time. This indicates that even though community colleges were formally considered LEAs, the considerations that went into the choice of the RFA measure related to their status as post-secondary institutions.

One of the states which funds OERs from state funds and tuition (no local money) asked ED to permit it to drop the RFA measure. This was denied, and ED "encouraged" it to continue its county property value per capita measure. This measure is based on the county in which each community college is located.

The other state where OERs receive no local revenue originally opted to eliminate RFA from its formulas. In late 1978, the state's formula was found to be out of compliance with the RFA requirement for OERs. Subsequently, the state adopted an RFA component in the formula in which RFA was measured as the projected cost per full-time equivalent student in vocational instructional programs. ED approved this measure.

2. Policy Analysis, Conclusions and Recommendations

OERs, which are primarily community colleges and postsecondary area vocational centers, are more diverse in their funding than LEAs. LEAs generally are funded from local property taxes and state aid, with the addition of smaller amounts of federal assistance. OER's, in contrast, may cover a portion of their costs with tuition payments, and their reliance on state and local tax revenues is highly variable from state to state. In some states funding is like secondary schools with heavy reliance on the local property tax (and in some states community colleges are related to school districts). In other states post-secondary institutions offering vocational education receive no funds from local tax sources. It has remained unclear under the VEA how RFA should be applied to such institutions and when various measures of RFA can be used.

Under the language of the regulations,[78] relative financial ability for OERs with a tax base is to be measured by the property wealth per capita of the OER - unless the tax effort measure is used.

However, under ED's most recent pronouncement, it is not clear whether all OERs with a tax base must use property wealth per capita, or only those that choose to be considered as LEAs to qualify for work-study and cooperative programs.[79]

Furthermore, in neither of the two states where community colleges receive local tax revenues was the RFA measure used (or approved by ED) property wealth per capita. One now uses a measure of state and local revenues per student; the other uses net [local] revenues, endowments and gifts per student. The point here is not that these measures are necessarily inappropriate, but that one could not predict that they would be acceptable under ED's interpretations of RFA. Under ED's interpretation an OER had to receive no local funds or receive a uniform level of state support to be eligible for these optional measures of RFA. The ambiguity of the term "uniform level of support from the State" may have led to this result.

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[78] The definition of "financial ability" is taken from the House Report accompanying the 1976 Amendments. See H.R. Rep. No. 94-1085 at p. 34.

[79] OVAE/DSVPO Program Memorandum FY 81-5 at 6 (Feb. 11, 1981).

This ambiguity is reinforced by the changes made by ED in the criteria for the use of alternatives to the property wealth measures. The first announced criterion required a state to provide "full financial support" for its OERs.[80/] More recently the criteria are that "an OER receives no local funds or receives a uniform level of support from the State"[81/] On its face, a "uniform level of support" would include a largely locally funded system of OERs in which the state provides a uniformly small flat grant to each OER.

ED's optional revenue measure of RFA is itself ambiguous. This measure is stated as "the amount of funds the State legislature makes available" to an OER. ED has not clarified whether this is the total amount of funds received by the institution or the amount per student. That ED appeared, at least at one time, to view this as the total amount received is indicated by an ED report which criticized the measure because it "does not take into account different size institutions/programs. . . ."[82/] This, of course, is true of the total amount received, which is an invalid basis for comparing institutions - a per student revenue measure is not subject to this problem. Fortunately, all of the states in our study which use a revenue measure

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[80/] Final Report of the DSVPO TAsk Force on Federal Fund Distribution Procedures, June, 1979 at 8.
[81/] OVAE/DSVPO Program Memorandum FY81-5 Feb. 11, 1981 at 6.
[82/] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 8.

of RFA do so on a per student basis. ED's lack of clarity here on use of total revenues or per pupil amounts, is, however, symptomatic of other serious problems resulting from a similar uncertainty about the use of per pupil calculations in other VEA formula calculations.[83] ED should clarify that any optional revenue measures of RFA must be calculated on a per pupil basis.[84]

We have also concluded that one of the optional measures of RFA for OERs that receive no local funds is inappropriate. Under this option the service area of each OER is determined and "a composite of relative financial ability [is computed] for all LEAs within the service area".[85] This means that even though the OER receives no revenues from local property taxes, the size of the local property tax base per capita is used as the measure of the OER's relative financial ability. One of our study states where OERs receive no local funds uses this measure of RFA. It is our conclusion that it is invalid to measure an OER's financial ability by a measure of taxing ability for a tax that is not used to support the OER. We recommend that this option be eliminated.

We agree with ED's current interpretation that relative financial ability should not be ignored as a funds distribution factor where OERs receive no local tax revenues but have differing fiscal abilities due to unequal state funding, differing tuition levels (which may reflect the economic status of the students), special grants and contracts and corporate donations. Consequently, we recommend that RFA be retained as a funds distribution factor in this situation.

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[83] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June, 1979 at 8.

[84] This is discussed in Chapter 2 at p. 29.

[85] OVAE/DSVPO Program Memorandum FY81-5, Feb. 11, 1981 at 6.

We also recommend that the VEA be clarified to permit OERs to use an optional revenue measure of RFA, similar to that recommended for LEAs in the preceding section. Under this option an OER would not have to be fully state funded to use a revenue measure of RFA. Rather, if local tax revenues amount to less than 25 percent of total revenues (less Federal), RFA could be measured by an OER's total revenues (less Federal) per pupil.

In fact, ED has permitted states to use similar measures for OERs having some local tax sources, in spite of issuing formal interpretations that appear to prohibit a revenue RFA measure in this situation. Our recommendation would authorize the current practice of using a revenue measure when small amounts of local tax revenues are used and would put parameters on the use of this measure.

We also recommend that the revenue measure of RFA be clarified to require OERs to include non-tax sources of revenues in this revenue measure. This would include such non-Federal sources as grants, contracts, gifts and endowments. With respect to the inclusion of student tuition, we recommend that states be given the option of including or excluding it in the revenue computation. We also recommend that states be given the option of using a revenue and student count for the total institution or only for vocational education. These are choices that will depend on matters such as state and OER accounting systems.

Finally, we recommend disapproval of ED's concept of "uniform level of support from the state" as a basis for qualifying for the optional measure of RFA. The uniformity of the level of state support by itself has little relevance to the relative financial ability of OERs. This uniform level could represent 95 percent of an institution's funding or 10 percent. Uniformity simply connotes a flat grant per institution or per pupil. Since local tax revenues can still be the predominant source of an OER's funding where the state provides a uniform level of funding, this concept should not be used to draw conclusions about the funding of OERs.

C. Higher Cost Students

1. Purpose and Organization

In addition to RFA, states are to distribute VEA funds to OERs on the basis of:

> the relative number or concentration of students whom they serve whose education imposes higher than average costs, such as handicapped students, students from low-income families, and students from families in which English is not the dominant language.[86]

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[86] See 106(a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

This factor serves a function which is parallel to the LEA low income factor: it seeks to target additional funds on recipients serving needier and more costly students. Unlike the low-income factor, which may measure the characteristics of the general *population* of the service area, the OER higher cost student factor identifies students requiring more costly educational programs which are *served* by the institution.

This section will focus primarily on three issues: (1) who are "higher cost" students, (2) what are appropriate measures of higher cost students, and (3) whether counting students as a higher cost student imposes any obligation on the OER concerning the services to be provided to such students.

2. Federal and State Legal Frameworks

The higher cost student factor was adopted as the other most important factor in distributing funds to OERs in the 1976 amendments to the VEA. The prior VEA, which did not distinguish between LEAs and OERs, had required that the needs of such students be given "due consideration" in VEA funding.[87] The 1976 amendments sought to ensure that they were, in fact, taken into account. The House Report included this factor because it "readily identifies those agencies most in need of this assistance". 88/

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[87] The 1968 Act required that:

> (B) due consideration will be given to the relative vocational education *needs of all population groups* in all geographic areas and communities in the State, *particularly* persons with *academic, socioeconomic, mental, and physical handicaps* that prevent them from succeeding in regular vocational education programs. [and that] . . .
>
> (D) due consideration will be given to the *cost* of the programs, services, and activities provided by local educational agencies *which is in excess of the cost which may be normally attributed to the cost of education in such local educational agencies*.

Section 123(a)(6)(B) and (D).

The VEA specifically indicates certain higher cost students that may be included: handicapped, low income and limited English-speaking. ED has interpreted the standard of "higher than average costs" to permit a state to include any student whose education imposes higher costs, except that ED has specifically excluded "comparative program costs (e.g., welding and typing)".89/

ED has interpreted "relative number or concentration" in the same way as in the case of the LEA low-income factor: as the proportion of such students. In this case, the proportion must be of "high cost vocational students to the total vocational student population of the institution".90/

Because local applications must be submitted to the state prior to the fiscal year for which funds are sought, ED permits OERs to estimate the future number of high cost students from

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88/H.R.Rep. No.94-1085 at 34.

89/*See, e.g.*, BOAE Discussion Paper, Suggested Procedures for Federal Funds Distribution P.C. 94-482 (1979) at 3.

90/*See, e.g.*, BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, November 1979 at 11, and subsequent manuals. The previous manuals did not specify "vocational students", but referred only to students. *See, e.g.*, BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, September 1979 at 9.

previous enrollments.[91]

ED, however, has not issued any interpretation on how students are to be counted, e.g., by a head count or on the basis of full time equivalents.

ED has interpreted these fund distribution requirements for OERs to be inapplicable to contracts with private vocational training institutes "or other existing institutions" which may be funded outside of the funds distribution process of section 106(a)(5).[92]

Out of four study states only two actually used the higher cost student factor in their VEA post-secondary formula. This was because one state considered its community colleges LEAs and used the LEA low-income factor instead, and another state effectively eliminated the higher cost student factor by treating all OERs as having the same proportion of such students based on the assertion that all OERs draw students from all over the state.

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[91] The Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 (Attachment: Issue #12), recommended that projections be used as the preferred method. Subsequent draft policy manuals repeated this as an option. See, e.g., Draft Manual for Federal Fund Distribution Procedures, Sept.1979 at 10.

[92] Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec.1979 at 11.

One of the states originally converted the one factor into three factors: (1) disadvantaged and handicapped enrollees enrollees, (2) black enrollees, (3) hispanic enrollees, and (4) the percent of persons below a certain poverty level. ED objected to four factors for higher cost students as giving too much weight to it. The current factor includes only one factor which includes both handicapped and disadvantaged students.

The other state includes students served who are handicapped, from low-income families, or from limited-English speaking families. Originally this state assumed that every OER served the state average percentage of handicapped pupils, which effectively eliminated handicapped students from the formula. Instead of calculating a percentage of higher cost students to total students in the OER, this state originally calculated the percentage of the total number of higher cost students in the state who were served in each OER. ED challenged these practices and now the actual number of handicapped students served is used and the percentage is the proportion of higher cost students to an OER's total students. This state uses a simple head count of students rather than full-time equivalents.

No state imposes any obligation on OERs concerning the services to be provided to higher cost students whom they count.

3. Policy Analysis, Conclusions and Recommendations

Although the VEA is fairly specific about which students to include, several of our states originally had problems in this regard. These problems appear to have been resolved and we see no need for further clarification of the general categories of students that can be included.

ED has not dealt with the issue of measuring higher cost students even though this may be a problem in some states. ED permits states to use simple head counts of such students rather than full-time equivalent students. Since post-secondary institutions such as community colleges enroll both full and part-time students and often sponsor special educational programs, a simple head count may give a distorted view of the student population. A simple head count works to the disadvantage of institutions that enroll greater proportions of full-time students and offer fewer short courses. For this reason, standardizing student counts by using a full-time equivalent basis (e.g., by using contract or credit hours) is usually necessary to accurately compare relative numbers or proportions of students among OERs.[93] We have not seen any studies indicating the degree to which higher cost student proportions are distorted by lack of full-time equivalency counts. The use of simple head counts may create an incentive to identify as many "high cost" students as possible without creating any incentive to provide appropriate programs. Thus, we flag this as a potential problem, with the recommendation that if OERs are able to calculate full-time equivalent students, such data be used for this factor.

Both the VEA and ED have been silent on the question of whether a state can provide greater weight for certain categories of students, e.g., handicapped, in calculating higher cost students. All of our study states simply added the numbers of students in different categories together. Using different weightings for different classifications of students based on cost variation is often done in state

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93/Since the VEA higher cost student measure is of the proportion of higher cost students to total students in the institution, the lack of full-time equivalency would not be a problem if higher cost students are equally represented among full and part-time students in all institutions. We doubt this is likely.

school finance formulas. We recommend that states be specifically authorized to use different weights for different types of higher cost students based on state estimates of the higher costs involved. Arguably, this is permitted under the current statute, but we doubt that this is clear to the states.

The VEA specifically requires that in order for higher cost students to be counted, they must actually be served by the OER: "students whom they serve whose education imposes higher than average costs". It is ambiguous, however, about whether such students must cost the institution more than an average amount to educate, or whether "average costs" refer to a general presumption about the amount needed to provide an appropriate education. ED has never required that a linkage be made between students identified as high cost students and the type, level or cost of the educational services provided. And no states we reviewed have made such a linkage.

Significantly, the VEA does not appear to require that the higher cost students counted by an OER be "served" in the institutions' vocational education programs. And, postsecondary institutions offering vocational education frequently offer an academic curriculum as well, *e.g.*, community colleges.

This would appear to indicate that Congress intended the higher cost student factor for postsecondary institutions to promote additional general assistance for vocational education to OERs that enroll higher proportions of these students and to create a general incentive for postsecondary institutions to serve them.

We would, however, recommend that states be granted specific authority to link the higher cost student factor to specific service for high cost students, if they choose.

CHAPTER 4

METHODS AND MECHANISMS FOR DISTRIBUTING VEA FUNDS

Chapter 4

METHODS AND MECHANISMS FOR DISTRIBUTING VEA FUNDS

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CHAPTER 4

METHODS AND MECHANISMS FOR DISTRIBUTING VEA FUNDS

I. Introduction

A. Purpose and Organization

In the preceding two chapters, the clarity, consistency and adequacy of the statutory terms describing the application approval priorities and fund distribution factors were analyzed. The purpose of this chapter is to describe and analyze the methods and mechanisms through which these application approval priorities and funds distribution factors are given effect.

This chapter is divided into four sections. Section I introduces the Federal legal framework, the major issues and our major findings, conclusions and recommendations with respect to the methods and mechanisms for distributing VEA funds among recipients.

Section II is the prelude to the remaining sections of this chapter. It describes and analyzes the requirement that states use a formula to distribute VEA funds among recipients.

Section III describes in greater detail the substance of the formula requirement and analyzes the clarity, consistency and adequacy of the formula design requirements in the legal framework.

Section IV describes the various mechanisms and methods states use when applying the formula requirement to distribute funds to recipients for the various required and permitted uses of VEA funds. It analyzes the use of funding pools and set-aside mechanisms as well as the project application funding method to meet these uses.

B. Overview of the Federal Legal Framework and Major Issues Raised

1. Requirement of a Formula

The VEA itself does not use the term "formula." This term first appeared in the appendix accompanying the final regulations issued in 1977, in which ED interpreted section 106(a)(5)[1] of the 1976 amendments to require states to use a formula to distribute VEA funds.

ED has interpreted the formula requirement to apply to most VEA funds, including funds carried over from a previous year or reallocated in the same year. The formula is only applicable to the distribution of Federal funds.

2. Content of a Formula

The statute specifies that the criteria set out in subsection 106(a)(5)(A) are to be used to give "priority" to applicants "in considering the approval of such applications" (application approval priorities). The "factors" for LEAs and OERs specified in subsection 106(a)(5)(B) are to be used as the basis for "determining the amount of funds available" to "applicants approved for funding" (fund distribution factors).

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[1] Section 106(a)(5) includes the application approval priority factors, funds distribution factors and prohibitions on the use of certain methods for the distribution of funds and a particular funds distribution outcome.

ED has interpreted the VEA as giving states the option of using two different mechanisms for giving effect to both the application approval priorities and the fund distribution factors. It has termed these two mechanisms the "two-step" process and the "one-step" process.

In a two-step process, the first step is approval of applicants and the second is funds distribution to approved applicants. In the first step, applicants are ranked according to the application approval factors (EDA and new programs) and "a cut-off point is established beyond which no recipient is funded." In the second step, the amount of VEA funds received by applicants approved for funding is determined by applying the funds distribution factors (relative financial ability and low income persons/higher-cost students).

In the one-step process, the two application approval priority criteria and the two fund distribution factors are combined into a single formula, which is used to rank applicants and allocate VEA funds based on each recipient's total score derived from the combination of these factors.

As noted above, the statute requires the fund distribution factors of RFA and low-income persons/higher cost students to be the "two most important" in determining the distribution of VEA funds. ED has interpreted this to mean that in a one-step process these funds distribution factors must individually receive the greatest weight in the process, and the application priority factors must individually be given lesser weight.

The statute also requires that VEA funding be based on "economic, social and demographic factors relating to the need for vocational education among the various populations and the various areas of the State. . . ." Other than the specification of two most important fund distribution factors and the application prioritity factors (included by ED interpretation), there has been additional factors that can be included in a VEA formula. ED, however, appears to have sought, in dealing with individual states, to discourage the use of additional factors.

3. Prohibited Methods and Outcomes

The statute prohibits two methods of funding and one distributional outcome. Section 106(a)(5)(B)(ii). First, the statute prohibits states from allocating VEA funds "among eligible recipients within the state on the basis of per capita enrollment." Second, it prohibits allocating VEA funds "through matching of local expenditures on a uniform percentage basis." Third, the statute prohibits a state from denying VEA funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."

4. Uses of VEA Funds

The VEA authorizes two kinds of uses for Federal funds: required and permitted. Required uses, in turn, are of two types. One type of required use results from Congress' establishment of a separate authorization or appropriation for a particular purpose, e.g., Subpart 4 (Special Programs for the

Disadvantaged), Subpart 5 (Consumer and Homemaking Education). The other type of required use results from Congress specifying that a certain percentage of a state's allotment must be used for a particular purpose, e.g., of subpart 2 and 3 funds, the state must use 10% for handicapped and 20% for disadvantaged persons. These percentage requirements are commonly called "set-asides."

There are also two types of permissive uses that are relevant to funds distribution issues. The first type requires that states must use priorities in addition to those specified for other VEA funds in allocating funds for these uses. For example, the section 121 work-study and the section 122 cooperative vocational education programs require a preference or priority be given for the factors of school dropouts and youth unemployment. These are considered "permissive" uses because the VEA does not require states to use their VEA funds for work-study or cooperative education. The second type of permissive use is distinguishable from the first by not being subject to any fund distribution priorities or factors in addition to the general requirements of Section 106(a)(5). Most of the uses of Subpart 2 Basic Grant Funds, other than work-study and cooperative education programs, are in this category.

C. Major Findings, Conclusions and Recommendations

1. Introduction

We found that all the states in our study used a formula to distribute VEA funds to recipients. These formulas employ three different methods of distributing funds:

(1) the percentage reimbursement method;

(2) the direct allocation method; and

(3) the project method.

Three of the states use their formulas to determine, for distribution of at least some VEA funds, a variable percentage of a recipient's total cost of vocational education or a percentage of a certain cost, e.g., teachers' salaries, equipment. Where this percentage reimbursement method is used, the percentage of costs remaining after the Federal percentage is calculated must be borne by the recipient from local and state funds. One state that has a specific categorical state aid program for vocational education coordinated the distribution of some state categorical vocational education aid with Federal funds through the percentage reimbursement calculation.

The one state that does not use the percentage reimbursement method uses its formula to calculate a direct allocation of VEA funds to each recipient. What percentage this represents of total funds for vocational education, for a vocational education program, or for a particular cost element, is irrelevent to the workings of the formula. Other states in our study also allocate VEA funds for some uses as a precise dollar amount without reference to a percentage reimbursement (while using the percentage reimbursement method for other funds).

Three of the four states used the formula with a project method of funding for at least some programs. In the project method, approved applications are ranked based on fund distribution factors and applicants are funded in the order of the ranking.

In each case, the formulas used were "one-step" formulas, i.e., formulas which combined the two application approval criteria and two funds distribution factors as formula variables.

We found the legal framework relating to the design of VEA formulas to raise three major issues:

(1) Is the requirement that a "formula" be used to distribute VEA funds among recipients appropriate and its applicability clear;

(2) Is the legal framework clear, consistent and adequate with respect to the design requirements for this formula; and

(3) How is the formula to be applied to the various uses of VEA funds?

2. The Requirement of a Formula

a. Major findings and conclusions -- ED has consistently interpreted the VEA to require states to use a "formula" to distribute VEA funds among applicants approved for funding. It is our conclusion that this interpretation is correct. A formula, properly constructed, is necessary to ensure that the statutory objective of "equalization of educational opportunity," particularly for recipients having below-average financial ability and above-average concentrations of low-income and higher-cost populations, is met.

The formula requirement by itself provides no assurance that the objective will be met. A funding formula is simply a mechanism for distributing funds whose results are based on arithmetically related variables and are both predictable and replicable. Although in this regard a formula is an "objective" mechanism for distributing funds, the mere existence of a formula does not preordain any particular result. The outcome of a formula is determined by such things as (1) the variables used in the formula; (2) how they interact in the formula; (3) how factors are scaled and interrelated; and (4) how formula scales relate to variation in amounts of VEA funds. All of these issues are considered in a later section of this chapter.

b. Major recommendations -- The requirement that there be a formula for distribution of VEA funds is the foundation for considering issues related to an equitable and educationally sensible distribution. The formula requirement is the core of a principled and consistent funds distribution system. We recommend that it be retained as the funds distribution mechanism.

3. General Formula Design Requirements

a. General findings and conclusions -- In general, we have found that the Federal legal framework has been unclear concerning basic formula design requirements and that some of ED's interpretations concerning the design of formulas have been inconsistent with the congressional objectives that VEA funds distribution requirements were intended to further. In addition, the statute and ED's interpretations do not establish a legal framework sufficient to address all of the issues that are essential for designing a VEA funds distribution formula.

Specifically, we identified four components of a formula which require greater clarity and precision in order to effectuate Congress' clear intentions:

(1) The number and types of formula factors;

(2) The scales of formula factors;

(3) The relationship of the factors to each other so that some are given greater importance than others; and

(4) The use of scales to determine VEA funding amounts.

As analyzed in this chapter, we found the framework for designing formulas to have been made needlessly complex. We make specific recommendations which are intended both to simplify the legal structure and ensure that VEA formulas carry out the objectives Congress intended, while at the same time affording states substantial flexibility in addressing particular vocational education needs.

b. The numbers and types of formula factors

i. The inclusion of the two application approval priorities as formula factors -- As described above and in Chapter 2, ED has interpreted the VEA to require that a state's VEA formula contain both the application approval priorities (new programs and EDA) and the two required fund distribution factors (RFA and low-income/higher cost students) if the state uses a so-called "one-step" formula. In Chapter 2 we concluded that inclusion of the two application approval criteria as formula factors did not give them the priority Congress intended.

Their inclusion also has a reciprocal effect on the required fund distribution factors: it tends to dilute and confuse the effect of the required fund distribution factors. This dilution is of particular significance because as discussed in Chapter 2, the application approval criteria of new programs and economically depressed areas are not appropriate concepts for determining the amount of funds recipients should receive and/or lack appropriate recipient specific measures. Not only does their use as fund distribution factors dilute the other appropriate factors, but it also makes it virtually impossible to predict the distributional effects of VEA funding formulas. As considered in Chapter 3, we have concluded that the RFA and the low-income persons/ higher cost student factors, if properly measured, are appropriate for carrying out congressional intent in the distribution of VEA funds. The application approval criteria, when turned into funding factors, are not.

In contrast, we agree with ED's interpretation of how the two required fund distribution factors should operate in a two-step process. In a two-step process application approval priorities are used to select applicants for funding (step 1) and then the two funds distribution factors are used in a formula to determine the amounts approved applicants will receive (step 2). In this case the formula is not confused by inclusion of application approval criteria.

Consequently, we recommend that Congress clarify that the application approval priorities of section 106(a)(5)(A) may not be used as fund distribution factors.

ii. The inclusion of additional formula factors -- At present, the VEA does not explicitly limit the number of factors that can be included in a formula so long as they are "economic, social (or) demographic." As described in the Federal legal framework, ED's Task Force Report stated that some states had created extremely complex formulas, with eight, ten, or more factors, with some factors using multiple indicators. ED has informally discouraged the use of any additional factors in a formula. We agree with ED's objection to the inclusion of factors in addition to those specified in the statute. The addition of factors is a major way that a formula can be manipulated to defeat intended distributional objectives.

We recommend that VEA formula factors be limited to the two now required by statute: for LEAs, RFA and low-income persons; for OERs, RFA and higher cost students. The use of only two factors will ensure the funding focus Congress has long intended, and will also make formulas simpler and more predictable in effect.

This recommendation will not decrease state flexibility in the use of funds; indeed, in conjunction with other recommendations, states will have greater flexibility. This recommendation must be read in conjunction with other recommendations contained in this report, i.e., that states be permitted to use measures of the RFA factor that they use in their own general aid to education formulas (see Chapter 3); and that states be permitted to override the allocation determined by formula based upon other objective criteria of relative recipient need for vocational educational services, equipment or facilities (discussed later in this chapter).

iii. The proper inclusion of a factor for the size of recipient vocational educational programs -- The VEA prohibits states from allocating VEA funds "among eligible recipients within the state on the basis of per capita enrollment." We found that, in some states, ED represented that this precluded the use of pupil multipliers or large additive factors; whereas, in others these per pupil factors were permitted.

It has not been clear under the VEA legal framework how the size or potential size of a recipient's vocational educational program could be taken into account without violating this prohibition. We conclude that there is no conflict between the "per capita" distribution prohibition and the appropriate use of a factor representing the size of recipients' programs, _e.g_., vocational enrollments. We recommend that Congress clarify that there is no conflict between them. We further recommend that in applying the fund distribution factors, states _be required_ to take into account the size or potential size of a recipient's vocational education program.

c. _The proper scaling of factors_

i. _Major findings and conclusions_ -- One of the first issues states have had to resolve in structuring their VEA formulas is how to scale the factors; that is how to convert the raw numbers of each factor into a numerical value which can be used (1) to compare applicants on that factor and (2) to combine with other factors in the formula.

ED has not developed guidelines with respect to scaling. As a result, states are free to use either of two methods of scaling: continuous and discontinuous. Continuous scaling converts the raw numbers into a different expression of their value but retains the actual range of variance between factors. Discontinuous scaling converts raw numbers into a different expression of their value which does not retain the actual range of variance between factors.

We conclude that the use of discontinuous scales distorts the actual variation of factors among applicants.

ii. Major recommendations -- We recommend that if Congress continues to be concerned with equalization as reflected in funds distribution factors, it should add a provision to the VEA that puts parameters on how these factors are scaled.

First, we recommend that continuous scales be required. Second, we recommend that parameters be placed on factor scales to ensure that there is a substantial correspondence between the ratio of variation of each fund distribution factor and the ratio of variation of the numbers used to scale each factor.

We specifically recommend that a scale parameter be based on the ratio of variation in the unscaled fund distribution factors (RFA, low-income and higher cost students). Other parameters could be selected which would ensure substantial, although not complete proportionality between factor and scale variation. For example, proportionality could be required, based on the full range or selected percentile range of variation, up to a specified maximum ratio.

In many formulas the points for each factor are combined to obtain a point total for each recipient and for all recipients in the state. We have recommended above that formulas contain only the two required fund distribution factors. In combining the points from the scales for these two factors, we recommend that parameters similar to those for the individual factor scales operate to govern their combination. A parameter on factor combination is needed because the simple addition of a constant value to the factor totals can render the individual factors largely irrelevant. Consequently, we recommend that Congress add a parameter on the ratio of factor difference when both fund distribution factors are combined. A possible parameter is that the ratio of lowest to highest possible combined factor scores be at a minimum not less than the average ratio of the individual factor ratios.

d. Relating the factors to each other so that some are given greater importance than others

i. Major findings and conclusions -- As described in the legal framework, ED has determined that two funds distribution factors must receive greater weight than any other formula factors.

We found that in response, states have developed different systems of weighting formula factors, i.e., multiplying a formula factor by a whole number or a fraction to adjust the relative effect of that factor in the formula.

When numerous factors are included in the formula, the weighting can operate to decrease the importance of the "two most important factors" even though they receive more weight than other factors.

ii. Major recommendations -- The problems of relating factors to each other and of determining their relative importance have arisen largely from the inappropriate inclusion of application approval priority factors in the formula and the lack of limitation on the number of factors. Dealing with these problems as we recommend will eliminate most problems concerning the relative weight to give specific factors. However, if Congress continues to permit additional factors, the weighting problem would be addressed, in part, by the ratio parameters for the formula factors as described in the preceding section.

e. The use of scales to determine VEA funding amounts

i. Major findings and conclusions -- As described in subsection (c) above, states must decide how to scale each formula factor to account for the variations among recipients. In addition, decisions must be made about how to convert each recipient's total score into the amount of funds each recipient will receive.

We found that the use of scales or other calculations to determine the amounts of VEA funding each eligible recipient will receive, after fund distribution factor amounts have been calculated and compared can be the most important step in a formula. Inappropriate decisions made at this stage can destroy the effects of a fund distribution formula that would otherwise appear exemplary. Although the VEA contains prohibitions on per capita distributions and uniform percentage matching, these issues have been largely ignored by ED's interpretations. We also found that in some states formulas had been designed, intentially or unintentially, in a way that circumvented these objectives and, in operation, would of mathematical necessity tend to allocate VEA funds in a manner that is close to a flat grant or uniform reimbursement.

We noted fewer problems in this regard in formulas that directly allocate VEA funds to recipients, i.e., those that do not use a variable reimbursement percentage or local match. The major problems of these direct allocation formulas appeared to be in the selection and definition of factors and factor scaling. Once the factor totals for these formulas were calculated the amounts of VEA funds allocated tended to be proportional to these totals. This is not, however, inherent in direct allocation formulas. If opportunities for reducing the degree of variation through formula selection and scaling are closed off, some states may seek to create scales that reduce the proportionality of factor totals to fund allocations. Thus, the recommendations that follow apply to both percentage reimbursements and direct allocations.

ii. Major recommendations -- It is our conclusion that if Congress intends that VEA funds be used to equalize for differences in RFA and low-income/higher cost students among recipients, the VEA must be clarified to give greater precision to the VEA requirements prohibiting per capita grants and uniform percentage reimbursements. The methods we recommend to accomplish this relate directly to the manner in which formulas are used to calculate the amounts of VEA funds recipients are to receive.

To ensure that VEA funds are allocated to recipients in proportion to their differences in financial ability and need for vocational services as shown by the RFA and low-income/ higher cost student factors, we recommend that ratio parameters be placed on the scales used to allocate VEA funds or if a scale is not used, then on the final allocation of VEA funds.

This ratio would not be calculated on the individual fund distribution factors, but rather would be determined by comparing the formula total of the eligible recipient with the lowest VEA formula calculation to the formula total of the eligible recipient with the highest formula calculation. This ratio of lowest to highest formula totals would establish the minimum ratio of variation for the amounts allocated to the lowest to highest score recipients (in the case of a direct allocation formula) or the lowest to highest percentage reimbursement (in the case of a percentage method).

We also recommend that states be permitted to override the allocation amount determined by the general formula on the basis of (1) objective criteria of specific need for vocational education that indicate that an eligible recipient has a greater need for the vocational education program or service being funded than would appear from the funding formula calculation. and (2) the agreement of recipients to use VEA funds to meet those needs.

4. Applying the General Formula Requirements to the Various Uses of VEA Funds

We found that states used a variety of methods and mechanisms to distribute VEA funds among the various permitted and required uses of VEA funds. We identified two mechanisms (funding pools and set-asides) and one method (the project method) which states use to direct VEA funds to particular uses.

a. Funding pools and set-asides

i. Major findings and conclusions -- Funding pools are separate portions of the total fund of money for which applicants separately apply. Most of the states in our sample use these to encourage recipients to use VEA funds for a particular purpose.

Set-asides serve a similar purpose. A set-aside is a specified portion of the total amount of funds that an applicant must agree to use for a certain purpose or in a certain manner. Unlike the funding pool, a set-aside is mandatory, i.e., in order to receive any of the total funds, the applicant must agree to spend a specified portion in a certain way.

We conclude that these mechanisms are important for carrying out Federal and state policies. Despite their importance to implementation of the various objectives of the VEA, ED has not provided clear, consistent or adequate guidance.

ii. Major recommendations -- We recommend that the use of funding pools and set-asides in the VEA be clarified. Of particular importance is the need to clarify the application approval priorities can be met only by establishing funding pools or set-asides which designate a specific amount of funds for these priorities and cannot be met by including them as factors in a formula.

b. The project method of funding

i. Major findings and conclusions -- The project method of funding is typically used to allocate VEA funds to particular uses.[2]

Under the project method, recipients typically propose their own funding levels and the VEA fund distribution factors are used to rank applicants for funding. Generally, applicants are funded in the order of their rank, and the amount of VEA funds they receive is the amount necessary to fully fund their approved applications. Often a variable local match is deducted. This local match is calculated based on the same formula used to rank applicants. Applicants below the point on the rank at which available funds run out receive no funds.

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[2] Section 3 of chapter 3 focuses on the other two methods of distributing funds: the direct allocation method and the percentage reimbursement method. The direct allocation method calculates a specific amount of VEA funds an applicant is eligible to receive. In contrast, the percentage reimbursement method determines a variable percentage of specified vocational education costs which Federal funds (or the local match) will pay for.

Although the majority of states we reviewed use the project method for funding some VEA purposes, the legal framework does not clarify how the fund distribution provisions apply to projects. It is clear that they apply from both the legislative history and ED interpretation. We identified two problems which require further clarification. First, it is not clear how states are to apply the distribution factors in a meaningful fashion if all applicants are to be funded under the project. Second, although a variable percentage reimbursement is often used in project funding ED has not required more than an inconsequential variation among recipients.

ii. Major recommendations -- We recommend several alternative parameters on the use of the project method which will remedy the problem of states not applying the funds distribution factors in a meaningful way.

The first alternative for ensuring that states use the fund distribution factors in project funding is to require an eligibility cut-off at a specific point on the ranking of potential applicants, such as the state average score in VEA funds distribution factors.

A second alternative would be to use the VEA formula to establish a planning entitlement for each potential applicant, which is the basis for applicants submitting project proposals to the state.[3]

In addition, we recommend that the formula override provisions recommended in subsection (e) for the direct allocation and percentage reimbursement methods of funding also apply as exceptions to the above parameters on project funding. This provision would permit states to override the application approval cut-off or the variable allocation for projects based on objective criteria of specific need for vocational education.[4]

The second problem, which is the inconsequential variation in percentage reimbursement under some of the projects we reviewed, would be remedied by our recommendation in subsection (e) of this chapter that a ratio parameter be placed on percentage reimbursements. As described in that section, the ratio parameter would require that the variation in VEA percentage reimbursements among recipients not be less than the ratio differences of recipients' total factor scores.

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[3] We also recommend that if either of these alternatives are adopted, Congress require states to report the ranking used for project funding and show on that ranking where the funding cut-off was made.

[4] This override provision also encourages states to expand access to vocational education and gives them greater flexibility in meeting their particular needs in vocational education.

II. The Requirement of a Formula

A. Introduction

1. Purpose and Organization

This section, which analyzes the requirement that states use a formula for distributing VEA funds among applicants approved for funding, is a prelude to subsequent sections which consider issues that have arisen from the use of formulas.

In subsection B we describe the Federal and state legal framework respecting the formula requirement. The state legal framework described here is a very abbreviated overview of the use of VEA formulas by states since specific formulas issues are considered in more detail later. Subsection C contains the analyses, conclusions and recommendations relating to the formula requirement.

2. Summary of Major Findings and Conclusions

ED has consistently interpreted the VEA to require states to use a "formula" to distribute VEA funds among applicants approved for funding. It is our conclusion that this interpretation is correct. A formula, properly constructed, is necessary to ensure that the statutory objective of "equalization of educational opportunity", particularly for recipients having below average financial ability and above average concentrations of low-income and higher cost populations, is met.

The formula requirement by itself presents no assurance that the objective will be met. A funding formula is simply a mechanism for distributing funds whose results are based on arithemetically related variables. Although in this regard a formula is an "objective" mechanism for distributing funds, the mere existence of a formula does not preordain any particular result. The outcome of a formula is determined by such things as (1) the variables involved in the formula; (2) how they interact in the formula; (3) how factors are scaled and interrelated; and (4) how formula scales relate to variation in amounts of VEA funds. All of these issues are considered in a later section of this chapter.

However, the requirement that there be a formula for distribution of VEA funds is the foundation for considering issues related to an equitable and educationally sensible distribution. The formula requirement is the core of a principled and consistent funds distribution system.

As discussed in later sections,[5] different formulas may be appropriate for the distribution of VEA funds for different uses, and in some cases it may be appropriate to override the distributional outcomes of a formula, e.g., where the formula does not provide a recipient with funds for services, equipment or facilities of sufficient size, scope or quality. A well constructed formula, however, is needed as the basis for establishing the presumed need for VEA funds which any overriding consideration should complement.

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[5] See section IV.

B. Federal and State Legal Frameworks

The VEA itself does not use the term "formula". This term first appeared in question 1 in the appendix accompanying the final regulations issued in 1977, in which ED interpreted section 106(a)(5) of the 1976 amendments to require states to use a formula to distribute funds.[6] Section 106(a)(5) includes the application priority factors (subsection (5)(A), the specification of funds distribution factors, (subsection 5(b)), and prohibitions on the use of certain methods for the distribution of funds and a particular funds distribution outcome (subsection 5(b)(ii)).

Section 106(a)(5)(B) specifies that when a state determines the "amount of funds available under the Act which shall be made available to these applicants approved for funding", it must "base such distribution on economic, social and demographic factors relating to the need for vocational education among the various populations and the various areas of the state, ..."[7] The statute goes on to require that the two most important factors must be relative financial ability and low-income persons (LEAs) or higher cost students (OERs).

There follows a paragraph prohibiting the states from allocating funds on the "basis of per capita enrollment or through matching of local expenditures on a uniform percentage basis". And the outcome prohibited is the denial of funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs".

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[6] 42 F.R. 53865 (Oct. 7, 1977)
[7] 20 U.S.C. 2306(a)(5)(B).

The funds distribution requirements of subsection 106(a)(5)(B)(i) were proposed by the House out of concern that VEA funds had not been used in a systematic way to equalize among recipients for differences in need resulting from variations in property wealth and personal incomes.[8] The House Report also set out a definition of the "financial ability" factor in order to "give greater preciseness to our intention in trying to focus Federal funds on those school districts and other public agencies most in financial need of these funds".[9]

The prohibitions of subsection 106(a)(5)(B)(ii) came from the Senate Bill, and their purpose was seen as essentially similar to earlier fund distribution provisions: "to require State boards to take into account the relative needs of applicants for Federal funds, and their relative ability to match such funds, in relation to other applicants within the State".[10] In this regard, the Senate indicated that states should not use a"formula" which ignored these factors: "Despite this provision, a number of States allocate funds among school districts on the basis of a flat formula without taking relative need or ability to pay into account."[11]

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[8] H.R. Rep. No. 94-1085 at 33.

[9] *Id.* at 34.

[10] S. Rep. 94-882 at 71.

[11] *Id.*

ED has interpreted the formula requirement to apply to most VEA funds. A formula must be used in allocating funds to eligible recipients under the Basic Grant (section 120), for Special Programs for the Disadvantages (section 140), for Consumer and Homemaking Education (Section 150) and for one particular program improvement and supportive service under Section 130, namely vocational guidance and counseling (section 134). Other program improvement and supportive services under section 130 can be provided by contracts and may be distributed outside of the formula requirement.[12]

Where the formula requirement applies, ED has also been clear that any distribution of unallocated funds or reallocations in the same year must be distributed by formula.[13]

ED has interpreted the VEA to require a formula and the use of VEA fund distribution factors only for VEA funds. Thus the formula requirement is considered inapplicable to state funds for vocational education, whether distributed as general state and or categorical state and for vocational education.[14] In contrast, the regulations apply other VEA requirements to state and local funds used to meet matching and maintenance of effort requirements.[15]

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[12] 42 F.R. at 53865 (Appendix B, Question No. 1) (Oct. 3, 1977).

[13] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 1; OVAE/DSVP Program Memorandum FY 81-5, (Feb. 11, 1981) at 2.

[14] BOAE/DSVPO Policy Memorandum, FY 79-8, Sept. 19, 1979 at 3.

[15] See 34 C.F.R. 400.185d, 222(b) (c) and (d), and 241(a)(i) and (ii) (planning requirements); and 34 C.F.R. 400.301(c) (all requirements).

ED has never explained the basis for excluding state funds from the formula requirement, but presumably it is based on section 104(b)(2) which specifies that, "The Commissioner shall not disapprove any plan or program plan and report submitted under this Act solely on the basis of the distribution of State and local expenditures for vocational education". The Senate Report indicated with respect to this provision that "the Commissioner's authority to disapprove a State's annual program plan is limited to its proposed allocation of Federal funds."[16/]

All of the states in our study used formulas to distribute VEA funds to recipients, but formula mechanisms differed from state to state. Some states used the formula to directly allocate the amount of VEA funds determined by the formula. Others use the formula to calculate a variable matching percentage reimbursement for specified program or equipment costs. In msot states the formula mechanism differed from program to program.

Most states also used a method of funding called the "project method" for certain VEA purposes[17/] Under the project method, the formula is used to rank applicants to determine the order of project approval and also typically to vary the percentage of

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16/ S. Rep. No. 94-882 at 75.

17/ See section IV for a more detailed discussion of the project method of funding.

local funds required to fund project.[18]

C. Findings, Conclusions and Recommendations

It is our conclusion that ED correctly interpreted the VEA to require states to use a formula to distribute VEA funds to recipients. A formula requirement is implied in the statutory fund distribution requirements and prohibitions; it appears to have been anticipated by the legislative history; and is necessary to implement the Congressional intent to equalize among recipients for differences in need for VEA funds.

The 1976 Amendments concerning funds distribution were adopted because Congress concluded that states had not seriously responded to the more general exhortations of prior legislation to give "due consideration" to factors such as financial ability and the high costs of educating certain students. In addition, the factors established in the 1976 amendments clearly require quantification and arithmetic comparison, *e.g.*, "*relative* financial ability", the "*relative* number or concentration" of low-income persons and higher cost students. It is precisely the characteristics of quantification of variables, and the use of arithmetic comparisons to determine funding amounts, that denote a "formula" - in contrast to more subjective bases for deciding the amount of funds each recipient shall receive. The formula requirement is reinforced by the fund distribution prohibition which refers to unacceptable bases for creating formulas - per capita enrollment and uniform percentage matching.

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[18] The details of these formulas are described in later sections. The factors used in these formulas are described in chapters 2 and 3 *supra*.

ED's interpretation that the formula requirement applies to the allocation of all funds under Part A of the Act, except those which can be distributed by contract, appears determined by the language of subsection 106(a)(5)(B) that fund distribution factors must be used "in determining the amount of funds available under the Act which shall be made available to these applicants approved for funding. . . ." (Emphasis added).

In our review of the use of formulas in four states, we did not find that the formula requirement itself created problems for states. In fact, several state officials indicated that this requirement was important to retain because without it the allocation of VEA funds would likely be subject to two undesirable pressures. The first is the course of least resistance: allocation of funds among recipients on the basis of a flat amount per pupil or uniform percentage reimbursement. The second is political: allocation of funds on the basis of the amount of pressure applicants can direct at the State Board. These two pressures are related. In an attempt to avoid political pressures, State Boards tend to favor flat grants which have the appearance of being "even-handed". For a State Board to take the initiative to allocate funds on the basis of the needs or financial abilities of recipients can be politically risky, since the less needy and more fiscally able recipients that receive fewer funds may respond with political pressure.

ED's interpretations concerning the funds to which the formula requirements apply were clear to the states in our study. The states understood which funds could be distributed by contract as opposed to formula and that state funds were not subject to the formula requirement.[19]

It is our conclusion that ED's interpretation that a formula is required for the distribution of VEA funds to recipients is correct. A formula, properly constructed, is necessary to ensure that the statutory objective of "equalization of educational opportunity", particularly for recipients having below average financial ability and above average concentrations of low-income and higher cost populations, is met.

The imposition of a formula requirement by itself, however, provides no assurance that this objective will be met since a funding formula is simply a mechanism for distributing funds whose results are replicable and based on arithmetically related variables. Although a formula is an "objective" mechanism for distributing funds, its existence does not preordain any particular result. Things such as the variables included in the formula, how they are scaled and interrelated, and how formula scales relate to variation in amounts of VEA funds, determine the outcome of a particular formula (these issues are considered in later sections).

19/ As discussed in Chapters 2 and 3 and in later sections in this chapter, states, however, were often confused about which factors had to be used, how the factors were to relate to each other, and how to create formulas that were appropriate for particular VEA uses.

However, the threshhold requirement that there be a formula for distribution of VEA funds is the foundation for considering issues related to an equitable and educationally sensible distribution. The formula requirement is the core of a principled and consistent funds distribution system.

As discussed in later sections, different formulas may be appropriate for the distribution of VEA funds for different uses. And, in some cases, it may be appropriate to override the distributional outcomes of a formula, e.g., where the formula does not provide a recipient with funds to provide services, equipment, or facilities of sufficient size, scope or quality. An appropriate formula, however, is needed as the basis for establishing the presumed need for VEA funds. In other words, the formula, at a minimum, establishes the baseline parameters for an objective funds distribution system.

Based on the constraints of section 109(b)(2)[20/], which prevent ED from disapproving a state plan "solely" on the basis of the distribution of state and local expenditures for vocational education, ED correctly limited the formula requirement to VEA funds.

However, for VEA objectives for funds distribution to be met, the allocation of state funds for vocational education cannot be ignored. States can, and do allocate state vocational

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[20/] 20 U.S.C. 2309(b)(2).

education funds in inverse proportion to VEA funds so as to defeat VEA equalization objectives. But to deal with this does not require that state funds necessarily be subject to the VEA formula requirement. As discussed in chapter 5, this issue can be addressed through clarification of the existing supplement, not supplant requirements of the VEA.

III. General Formula Design Requirements

A. Introduction

1. Purpose and Organization

This section analyzes the VEA requirements governing the design of the formulas states use in allocating VEA funds among eligible recipients.

This section is divided into four subsections. The first subsection A provides an overview of the issues and the major findings and conclusions. Subsection B describes the Federal legal framework. The state legal framework is described in subsection C. Subsection D provides a detailed discussion of our findings, conclusions and recommendations.

2. Summary of Major Findings and Conclusions

In general, we have found that problems have arisen in the Federal legal framework with respect to four issues:

(1) the number and types of formula factors;

(2) the scaling of formula factors;

(3) the relationship of the factors to each other so that some are given greater importance than others; and

(4) the use of scales to determine VEA funding amounts.

In general, we have found that the Federal legal framework has been unclear concerning these formula design requirements and that some of ED's interpretations concerning the design of formulas have been inconsistent with the congressional objectives that VEA funds distribution requirements were intended to further. In addition, the statute and ED's interpretations do not establish a legal framework sufficient to address all of the issues that are essential for designing a VEA funds distribution formula. As analyzed below, the framework for designing formulas has been made needlessly complex. Our recommendations made in this section are intended both to simplify the legal structure and ensure that VEA formulas carry out the objectives Congress intended, while at the same time affording states substantial flexibility in addressing particular vocational education needs.

B. Federal Legal Framework

1. The Number and Types of Formula Factors

By statute the amounts of VEA funds distributed to approved applicants must be based on "economic, social and demographic factors relating to the need for vocational education among the various populations and the various areas of the State. . . ."[21/]

In addition, the statute specifies the "two most important factors in determining this distribution". For LEAs these must be (1) the relative financial ability of such agencies and (2) the relative number or concentration of low-income families or individuals within such agencies.[22/] For OERs these must be (1) the relative financial ability of such recipients

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[21/] Sec. 106(a)(5)(B) of the VEA (20 U.S.C. 2306(a)(5)(B)).

[22/] Sec. 106(a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i)).

and (2) the relative number or concentration of students whom they serve whose education imposes higher than average costs.[23]

The House, which proposed these factors, indicated that they were to ensure that the most needy applicants would receive more VEA funds.[24]

In addition to these fund distribution factors, the VEA also requires that states, in approving applications, give priority to the following types of applicants:

1. applicants located in economically depressed areas and areas with high rates of unemployment, and unable to provide the resources necessary to meet the vocational education needs of those areas without Federal assistance; and
2. applicants that propose new programs.[25]

These priorities were proposed by the Senate.

The first priority, often termed the "economically depressed area" (EDA) priority, was intended by the Senate to serve a purpose similar to that of the House-proposed fund distribution requirements: to give priority to "poor areas which cannot otherwise afford necessary vocational education programs" and to further the objective of "equalization of educational opportunity".[26]

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[23] Id. These LEA and OER factors are discussed in greater detail in Chapter 3.

[24] H.R. Rep. No. 94-1085 at 34.

[25] Sec. 106(a)(5)(A) of the VEA (20 U.S.C. 2306(a)(5)(A)). These application approval priorities are discussed in detail in Chapter 2.

[26] S. Rep. No. 94-482 at 70.

The second priority, for new programs, was to operate in tandem with the Senate-proposed amendment to the Declaration of Purpose concerning the use of VEA funds to maintain programs.[27] The Senate intended that its "bill as a whole" stress "the use of Federal funds as a catalyst for development of new programs States and localities would otherwise not be able to afford".[28]

When the Conference Committee on the 1976 Amendments reconciled the Senate and House bills, the two application approval priorities were taken verbatim from the Senate bill and the two funds distribution factors were taken verbatim from the House bill. The Conference Committee perceived that both Houses were seeking to tighten the VEA funds allocation process and clarify that VEA funds are to be distributed to recipients most in need of funds.[29]

2. The Relationship of the Fund Distribution Factors to the Application Approval Priorities

Under the statute, the criteria set out in subsection 106(a)(5)(A) are to be used to give "priority" to applicants "in considering the approval of such applications". And the "factors" for LEAs and OERs specified in subsection 106(a)(5)(B) are to be used as the basis for "determining the amount of funds available" to "applicants approved for funding".

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[27] "It is also the purpose of this part to authorize Federal grants to States to assist them (1) to improve, and where necessary, maintain existing programs of vocational education". Sec. 101 of the VEA (20 U.S.C. 2306) (Emphasis added).

[28] S. Rep. No. 94-882 at 57.

[29] H.R. Conf. Rep. No. 94-1701 at 220.

The House referred to its amendments as relating to the distribution of funds and as intending "to provide additional revenues to those school districts and agencies most in need of those revenues to provide programs" and to "focus Federal funds" on such agencies.[30]

The Senate saw its amendments as giving states the basis on which to make "hard choices among competing applications for scarce Federal funds". It anticipated that its criteria would be used to give "priority in approval of applications".[31] And, it stated that "[o]ther applications may, of course, also be approved, but the State board should be able to document the reasons for approval of such applications over those of needier applicants."[32] In contrast, the paragraph of the Senate Report, which follows the above discussion of the application approval priorities, refers to the "allocation of funds among eligible recipients" in reference to other amendments which the Senate proposed pertaining to the prohibited funds distribution methods set out in section 106(a)(5)(B)(ii).[33]

ED has interpreted the VEA as giving states the option of using two different mechanisms for relating the application approval priorities and fund distribution factors. It has termed these two mechanisms the "two-step" process and the "one-step" process.

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[30] H.R. Rep. No. 94-1085 at 33-34.

[31] S. Rep. No. 94-882 at 70.

[32] *Id*.

[33] *Id*. at 71.

In a two-step process the first step is approval of applicants and the second is funds distribution to approved applicants. In the first step, applicants are ranked according to the application approval factors (EDA and new programs) and "a cut off point is established beyond which no recipient is funded". In the second step, the amount of VEA funds received by applicants approved for funding is determined by applying the funds distribution factors (relative financial ability and low-income persons/higher-cost students).[34]

In the one step process, the two application approval priority criteria and the two fund distribution factors are combined into a single formula, which is used to rank applicants and allocate VEA funds based on each recipient's total score from the combination of these factors.[35]

As noted above, the statute requires the fund distribution factors of RFA and low-income persons/higher cost students to be the "two most important" in "determining" the distribution of VEA funds. ED has interpreted this to mean that in a one step process these funds distribution factors must individually receive the greatest weight in the process;[36] and the application priority factors must individually be given lesser weight. ED illustrated this in one of its draft funds distribution manuals by showing the RFA and low-income person factors each having a point scale of from 0-30, and the EDA and new program factors each having a point scale of from 0-20.[37]

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[34] See, e.g., BOAE/DSVPO Draft Policy Memorandum FY 80-____ at 1; BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 4.

[35] BOAE/DSVPO Draft Information Manual for Federal Vocational Education Fund Distribution Procedures, Dec. 1979 at 4. One of ED's draft interpretations implied that a cut-off point could not be used in a one-step process to deny funds to eligible applicants.

[36] Notice of Interpretation, 45 F.R. 81814 (Dec. 12, 1980).

ED's earlier interpretation expressed some uncertainty about the legality of the merger of the application approval and fund distribution factors in the one-step process: "P.L. 94-482 clearly anticipated a two-stage funding process (1) approval of applicants and (2) fund distribution to approved applicants".[38] The one-step process was justified, however, on the ground that the two-step process anticipates that some applicants will not be funded and the statute and regulations did not require this result:

> "In actual practice, many states distribute Federal VEA funds to all applicants. Although the intent of P.L. 94-482 was to establish separate approval/selection and funding stages, there is nothing in the Law or Regulations to prohibit a state from funding all applicants. In situations where all applicants are funded, an initial prioritizing and approval process becomes meaningless."[39]

3. Inclusion of Additional Factors in Funds Distribution Formulas

The statute requires that VEA funding be based on "economic, social and demographic factors relating to the need for vocational education among the various populations and the various areas of the State. . . ."[40] Other than the two most important fund distribution factors and the application priority factors (included by ED interpretation), there has been no written interpretation concerning the number or types of additional factors that can be included in a VEA formula. ED's 1979 Task Force Report noted that many states "have created extremely complex mathematical formulas with eight, ten or more factors with each factor defined according to several indicators. . . . The more factors contained in a formula, the greater the effect in diluting the formula outcome."[41] ED has asked several states to eliminate additional factors such as for minority students and training needs,[42] without indicating whether these fell outside of the statutory category of "economic, social and demographic factors" anticipated by the VEA.

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[37] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 16.

[38] DSVPO/BOAE Draft Information Manual for Federal Fund Distribution Procedures, Dec. 1979 at 4.

[39] Id.

4. How Factors are to Function in a Formula

The statute does not specify how fund distribution factors are to function in a formula except, as described above, to require that the factors set out in subsection 106(a)(5)(B)(i) be the "two most important factors" in the distribution of VEA funds.[43]

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[40] Section 106(a)(5)(B) of the VEA (20 U.S.C. 2306(a)(5)(B)).

[41] DSVPO Task Force Report, 79 at 9.

[42] It is not clear why ED insisted these be removed. It appears that ED concluded they were not adequate proxies for the statutory factors, although it is not clear whether they could be used as other economic, social or demographic factors.

ED's interpretations concerning how factors are to function have been confined largely to setting out the one-step and two-step process as described above. The June, 1979 DSVPO Task Force Report on Federal Fund Distribution Procedures and the early drafts of the proposed Manual for Federal Fund Distribution Procedures, however, provided insights into ED's views of other issues concerning how factors are to function in a formula.[44]

The Task Force Report reviewed a number of state distribution procedures and categorized them into three types:

1. allocation of funds based on varying dollars per student;
2. percentage support of total cost; and
3. percentage of Federal funds available.

ED then sought to develop model formulas for each of these three types of allocation methods that would meet VEA requirements.[45] Each of the three model formulas were one-step processes which combine application priority criteria and fund distribution factors in a single distribution formula.

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[43] Section 106(a)(5)(B).

[44] See generally, Final Report of the DSVPO Task Force on Federal Fund Procedures, June 1979; Draft Manual for Federal Fund Distribution Procedures, Sept., 1979.

[45] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept., 1979 at 13.

Model Formula No. 1 - Allocation of Federal Funds on a Per Student Basis

The first model formula was for allocating Federal funds on a per student basis.[46] This formula was expressed mathematically as follows:

2(RFA + LIF) + EDA + NP = Total Points for Eligible Recipient

$$\frac{\text{Total Points for Eligible Recipient}}{\text{Total Earned Points for all LEAs(or OERs) Statewide}} = \begin{array}{l}\text{Decimal Valu-}\\\text{ation (ER's}\\\text{proportion of}\\\text{total state}\\\text{points)}\end{array}$$

This decimal valuation was used to calculate the amount of VEA funds per vocational pupil an eligible requirement would receive. The factors were defined as follows:

a) RFA (Relative Financial Ability - property wealth per capita of the total population contributing to that wealth)

b) LIF (Concentration of low-income families in an LEA compared to the state concentration)

c) EDA (Economically Depressed Areas - points will be based on whatever measurable factor the state uses to determine this. If it includes unemployment rate, the GU factor can be dropped).

d) GU (General Unemployment - based on the unemployment rate)

e) NP (New Programs - based on the percentage of the proposed budget in the application devoted to new programs to meet emerging manpower needs)

The RFA and LIF factors were made the two most important factors by multiplying them times two. The "EDA" application approval factor had two factors: an EDA factor and a general unemployment factor.

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[46] *Id.* at 13.

Each factor was scaled by giving one point per standard deviation from the statewide mean value of that factor. An 11 point scale running from 0 to 10 was used, with 0 being five standard deviations below the mean and 10 being five standard deviations above the mean. To illustrate this the Draft Manual gave a hypothetical point scale for the New Program factor (percentage of an eligible recipient's budget proposed for new programs). The hypothetical mean percentage of budget proposed for new programs is 36.67% with a standard deviation of 5.56%. According to ED, the scale would appear as follows:

S.D.	(-5)	(-4)	(-3)	(-2)	(-1)	(MEAN)	(+1)	(+2)	(+3)	(+4)	(+5)
% of N.P.'s	8.87	14.43	20.	25.55	31.11	36.67	42.23	47.79	53.35	58.91	64.47
Points for N.P.'s	0	1	2	3	4	5	6	7	8	9	10

Mean, standard deviation, and the range of points would be calculated in a similar manner for each of the factors in the formula. The points, when calculated for all factors for each eligible recipient, are added together in the manner indicated in the formula shown above to arrive at the total points for each eligible recipients.

Model Formula No. 2: Allocation of Funds on a Percentage of Total Eligible Recipient Programs Cost

As described by ED, this formula was designed to rank order eligible recipients based on their total points and to assign a varying percentage of total program costs to recipients, also based on total points.[47] In this model formula, ED used the same factors as in formula 1, except that EDA had a single factor for unemployment rate.

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[47] Id. at 16.

Unlike formula 1 in which each factor had the same 10 point rank, formula 2 used different scales for the various factors. For example, RFA had a scale of from 0 to 30 points; whereas the new program factor was assigned a scale of from 0 to 20 points. According to ED, by increasing the range of the scale, the importance of the factor would be increased.[48]

To determine how many points will be assigned for each particular value of a variable, the state is to assign a point value to the full range of raw numbers for eligible recipients on each variable.

ED gave the following example of such a scale for the OER higher cost student factor:[49]

Relative number of high cost students

Percent of high cost students	Points
31 and above	30
26 - 30	25
21 - 25	20
16 - 20	15
11 - 15	10
6 - 10	5
0 - 5	0

Based on such scales, points are assigned to eligible recipients for each factor. The total points for each eligible recipient are calculated and then eligible recipients are ranked in order of total points. Using this ranking, the state establishes a funding scale which establishes the percentage of total vocational program costs to be paid for by VEA funds.

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[48] Id. at 17.

[49] Id.

ED gave the following example of such a funding scale:

	Ranking Category	Federal Funds as a % of Total Cost
I	90-99 points	97%
II	80-89 points	89%
III	70-79 points	81%
IV	60-69 points	73%
V	50-59 points	65%
VI	40-49 points	57%
VII	30-39 points	49%
VIII	20-29 points	41%
IX	10-19 points	33%
X	0-9 points	25%

ED also provided an example of how the variable Federal percentage would be used to calculate the amount of Federal funds an eligible recipient would receive.

OER#	Ranking Category	% Federal Funding	X	Program Cost	=	Federal $
1	V	65%		$90,000		$58,500
2	II	89%		$50,000		$44,500
3	IV	73%		$78,000		$56,940
				$218,000		$159,940

Model Formula No. 3: Allocation Based on a Percentage of Total Federal Funds Available

Under Model Formula 3, the relative importance of each variable according to ED is determined by the percentage of the total amount of VEA funds distributed under the formula that is governed by each factor.[50] ED set out the following formula do this:

.35 (State Allocation) (LIF Factor) + .35 (State Allocation)
(RFA Factor) + .15 (State Allocation) (sic) + .10 (State Allocation)
(NP Factor) + .05 (State Allocation) (ADM Factor) = LEA Allocation

Thus, under this model the RFA factor is given greater weight because it governs 35% of the total funds in contrast to the new program factor which govern only 10%.

As in the other two model formulas, scales must be developed for each factor to take into account factor variation among eligible recipients. Of note in this model is that ADM (the number of students enrolled in an ER or in its vocational program) is a separate additive factor under which "only 5% of the total allocation will be distributed on the basis of ADM".[51]

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[50] Id. at 18.

Model Formula 3 introduced the concept of "planning entitlement". The amount of a planning entitlement, which is a preliminary calculation of the amount of funds an applicant may be entitled to receive under a formula, may be different from the amount actually distributed to the applicant. ED explained that "[a]ctual fund distribution is the result of approved applications. If the planning entitlement for an LEA exceeds that LEA's approved application for funds, the remaining funds are redistributed (via the formula) to those LEA's with a need for additional funds."[52]

These model formulas did not appear in ED's draft of the Manual for Federal Fund Distribution Procedures after the September, 1979 draft; nor do later written materials mention them. However, these models appear to have substantially reflected ED's interpretations of the use of funding factors in VEA fund distribution formulas, as confirmed in communications with individual states.

5. The Prohibition on Allocation of Funds on the Basis of Per Capita Enrollment

One of the statutory constraints on the design of VEA funding formulas is the prohibition on states allocating VEA funds "among eligible recipients within the state on the basis of per capita enrollment".[53]

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[51] Id. at 18.

[52] Id at 19.

[53] Sec. 106(a)(5)(B)(ii) of the VEA (20 U.S.C. 2306(a)(5)(B)(ii)).

This provision was added in 1976 in response to the Senate's contention that "a number of states allocate funds among school districts on the basis of a flat formula, without taking relative need or ability to pay into account."[54]

This provision was not interpreted in the October, 1977 regulations, but a later policy directive stated that this provision prohibited "a fund distribution procedure which provides a guaranteed minimum amount to every eligible recipient *outside* the formula".[55] Subsequent interpretations also applied the prohibition to flat funding levels *within* VEA formulas: "a flat *minimum* funding level may not be *built into* the formula".[56] A later draft manual stated: "[T]he State does not establish a proportional or predetermined funding level based on the number of students."[57] However, ED's latest interpretation of this issue prohibits states from allocating funds "*solely* on the basis of per capita enrollment".[58]

The prohibition on a flat distribution per student raised the issue of how to take into account the number of students enrolled in an eligible recipient's vocational program in the allocation of VEA funds. In ED's Task Force Report the following statement appears, "ADM [average daily membership] or FTE [full time equivalent] student data may be used as a multiplier to direct funds to large student populations after relative need is computed".[59] Later in this report in describing Model formula no. 3, supra, it stated "only 5% of the total allocation will be distributed on the basis of ADM...." According to ED, this model formula "allows some funds to gravitate to where the students exist".[60]

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[54] S. Rep. No. 94-882 at 71.

[55] Policy Directive Relating to Fund Distribution from Charles Buzzell to Assistant Regional Commissioners, Feb. 1978.

[56] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures Sept. 1979 at 13.

[57] Draft Notice of Interpretation May 1980 at 5.

[58] OVAE/DSVP Program Memorandum FY 81-5 (Feb. 11, 1981) at 3.

A later draft interpretation described two ways a state could take into account the number of students enrolled in a recipient's vocational education program.[61] First, when "applicant priority ranking and fund distribution factors are being converted into dollars it may be necessary to incorporate a multiplier in the computation which takes into account the size of the program, number of teacher units or number of students enrolled".[62] A second way was to use a project method under which the state considers "approved budgets to ensure that total dollars awarded each applicant also relate to the size of the program, *i.e.*, the number of teacher units, or number of students enrolled".[63]

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[59] Final Report of the DSVPO Task Force on Federal Fund Distribution Procedures, June 1979 at 8. This statement also appears in the BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 18.

[60] *Id.*

[61] BOAE/DSVPO Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Procedures, July 1980 at 6. The project method of funding is discussed, *infra* in section IV.

[62] *Id.*

[63] *Id.*

A subsequent ED Program Memorandum gave the same interpretation with additional specifications, including the "size of the program may be used within a formula if it is properly weighted in relation to the required factors or the state may choose to multiply the enrollment factor by the sum of the other factors in the fund distribution".[64]

6. The Prohibition on Allocating Funds through Matching of Local Expenditures on a Uniform Percentage Basis

The statutory prohibition on allocating VEA funds "through matching of local expenditures on a uniform percentage basis" is a companion to the prohibition on per capita enrollment distributions.[65] This provision was also contained in the 1968 VEA.[66] Both houses of Congress found that states had ignored this prohibition. In restating it, Congress exhorted ED "to make vigorous efforts to enforce it. Otherwise poor school districts will continue to be barred from receiving funds when they are not able to come up with local matching funds".[67]

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[64] OVAE/DSVPO Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

[65] Sec. 106(a)(5)(b)(ii) at the VEA (20 U.S.C. 2306(5)(b)(ii)).

[66] "Funds made available under this title will not be allocated to local educational agencies in a manner, such as the matching of local expenditures at a percentage ratio uniform throughout the State, which fails to take into consideration the criteria set forth in paragraphs (A), (B), (C), and (D). Sec. 123(a)(6)(E) at the VEA of 1963 as amended by P.L. 90-576 (20 U.S.C. 1263(a)(6)(E)).

[67] H.R. Rep. No. 94-1085 at 34. The Senate Report stated the same admonition: "The Committee expects the Office of Education to be diligent in enforcing this provision, as otherwise the priorities expressed by the bill will be negated". Sen. Rep. No. 94-882 at 71.

ED has not interpreted this provision except to include in an early draft Manual on Federal Fund Distribution Procedures an example of a formula using a variable percentage match.[68]

7. The Prohibition on Denying Funds to Recipients Making a Reasonable Tax Effort Solely Because of Inability to Pay the Non-Federal Share of New Program Cost

The 1976 VEA amendments continued the earlier enacted prohibition on denying VEA funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."[69]

The Senate Bill in 1976 proposed a similar provision which did not contain the requirement that a recipient be making a "reasonable tax effort".[70] The final Bill approved by the Conference Committee, however, continued this prior requirement of the 1968 amendments. ED has not interpreted this prohibition.

8. Information States and Applicants Must Provide About Formulas

The VEA requires states to submit certain information to ED concerning the distribution of VEA funds. The five year state plan is to include a description of state goals in meeting the need for particular job skills in terms of "the allocation of all local, State and Federal financial resources available in the State among...institutions within the State", and provide the reasons for choosing these "allocations of resources".[71] The statutory requirements concerning annual program plans and accountability reports are even more explicit concerning the information on funds allocation that must be included. Here the state must in its planning provisions "set out explicitly the proposed distribution of such funds among eligible recipients, together with an analysis of the manner in which such distribution complies with the assurance given in the general application under section 106(a)(5) relating to the distribution of Federal funds";[72] and in its "reporting provisions" of these reports "show explicitly how funds available under this Act have been used during that fiscal year, including a description of the uses of funds among the authorized uses of funds set out in sections 120, 130, 140 and 150, and including a description of the distribution of these funds among local educational agencies and other eligible recipients in conformity with the requirements contained in section 106(a)(5), and give the results achieved with these funds...".[73] As interpreted by ED, the annual program plan is to include "a more detailed description" of how the funds projected in the five-year plan will be used and any change in the funding proposed.[74]

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[68] Described supra at p. 44.

[69] Section 106(a)(5)(b)(ii). In the 1968 VEA this provision was stated as follows: "no local educational agency which is making a reasonable tax effort, as defined by regulations will be denied funds for the establishment of new vocational education programs solely because the local educational agency is unable to pay the non-Federal share of the cost of such new programs". Sec. 123(a)(6)(E) of the VEA of 1963 as amended by P.L. 90-376 (20 U.S.C. 1263(a)(6)(G)).

[70] Senate Bill No. 2657, Sec. 107(a)(7): "...no eligible recipient will be denied Federal funds for the establishment of new vocational education programs solely because of its inability to pay the non-Federal share of the cost of such programs".

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[71] Sec. 107(b)(2)(A)(iv) and (B) of the VEA (20 U.S.C. 2307(b)(2)(A)(iv)) and (B)).

[72] Sec. 108(b)(1)(B)(ii) of the VEA (20 U.S.C. 2308(b)(1)(B)(ii)).

[73] Sec. 108(b)(2)(B) of the VEA (20 U.S.C. 2308(b)(2)(B)).

Early draft fund distribution manuals and the DSVPO Task Force Report specified that states should report funds distribution results for *at least two LEAs and two post-secondary institutions* approved for funding. "These examples will demonstrate the funds distribution procedures provide the largest allocation of funds *on a per student basis* to eligible recipients with the greatest needs".[75] Subsequent policy documents have omitted the "greatest needs" language.[76]

More recent policy documents[77] require states, as part of their annual application for funds, to describe clearly the priority and fund distribution factors and the way in which they are used to distribute funds, and to describe the amount of funds "*each*" eligible recipient will receive through the proposed fund distribution procedure.

C. State Legal Framework

1. Introduction

The description of the state legal framework relates to the major features of state formulas for allocating VEA funds among eligible recipients. It does not provide detail on the definitions and measurements of the application approval criteria and the fund distribution factors. These were described in chapters 2 and 3. Rather, we describe here how these criteria and factors generally interrelate in a formula to determine the amount of funds each eligible recipient is to receive.

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[74] VEA Regulations, Comment Re: Section 104.222 42 F.R. at 53874 (Oct. 3, 1977). *See also* Appendix B, Q + A #7, *Id.* at 53865.

[75] *See* BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 13. Final Report of the DSVPO Task Force on Federal Funds Distribution Procedures, June 1979 at 11.

[76] *See e.g.*, BOAE/DSVP Draft Policy Memorandum, Dec. 1980 at 2. *See also* BOAE/DSVPO Draft Policy Memorandum, Dec. 1980 at 2.

[77] Draft Notice of Interpretation (May 1980); Notice of Interpretation (45 F.R. 81814 (Dec. 12, 1980).

Thus, in this section there is a general description of state formulas which forms the basis for the general discussion of formula issues that follows. A separate description of how states vary their formulas to accommodate different uses of VEA funds is contained in section IV of this chapter; for example, how states may vary their formulas when they distribute funds for handicapped vocational students and how formula factors are used in the "project" funding approach are considered in section IV of this chapter.

In general, these observations are of the formulas in effect in the four study states for school year 1980-81 (FY81).

2. Types of Formula Factors

Every state in our survey used the one-step process to distribute all or most of their VEA funds. Consequently, they were required by ED to use both the fund distribution factors and the application approval criteria in the same formula. Every state currently uses the two fund distribution factors (RFA and low-income/higher cost students) as formula variables and every state also included at least one factor for economically depressed areas.[78] Three states also include a factor for new programs.[79] Some states during FY81 also included additional factors.[80] For example, one state includes a separate additive factor for ADM (average daily membership). This state does not otherwise take the student enrollment of recipients into account in allocating funds. Another state uses a student dropout factor in its general secondary formula. Another includes a factor for percentage of total students participating in vocational education.

In earlier years, following the 1976 amendments, some of these states used additional factors. These included factors for training needs, minority students, percent of tuition increase (OER formula), mean family income, and student attendance (either secondary or vocational education). One state had seven separate factors in its general post-secondary formula. Our interviews indicated that most of these factors had been eliminated by FY81 as a result of pressure from ED, or were simply dropped when the state included - for the first time - fund distribution or application approval factors required by ED.

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[78] As described in Chapter 2, one state uses two factors for EDA: the Department of Commerce factor and a general unemployment factor. (See Chapter 2 at page 21.)

[79] The one state that does not include a new program factor gives priority to new programs by establishing a funding pool for this purpose. One of the other states having a "new program" factor uses a fiscal capacity measure for it similar to that for its relative financial ability factor.

[80] The reference here is to the general formula for secondary and post-secondary VEA programs. A number of states, in addition, use additional factors, such as student dropouts, to meet the the additional priorities for work study, cooperative education and other programs. These are discussed in chapter 2 and in section IV of this chapter.

3. How Factors Function in State Formulas

a. Introduction -- The description of how factors function in state formulas is organized somewhat differently than the parallel section in the Federal legal framework. This is because in order to describe the relationship of the fund distribution factors to the application approval priorities in state formulas, it is first necessary to describe generally how state formulas operate.

Three of the states use their formulas to determine, for distribution of at least some VEA funds, a variable percentage of a recipient's total cost of vocational education or a percentage of certain costs, *e.g.*, teachers' salaries, equipment. Where the percentage reimbursement method is used, the percentage of costs remaining after the Federal percentage is calculated must be borne by the recipient from local and state funds. One state that has a specific categorical state aid program for vocational education coordinated the distribution of state categorical aid with Federal VEA funds through the percentage reimbursement calculation.[81]

The one state which does not use the percentage reimbursement method uses its formula to allocate a specific entitlement of VEA funds to each recipient. What percentage this represents of total funds for vocational education or for a vocational education program or a particular cost element, is irrelevant to the workings of the formula.[82] Other states in our study also allocate VEA funds for some uses as a precise dollar amount without reference to a percentage reimbursement (in addition to using the percentage reimbursement method for other funds).

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[81] This is further discussed in chapter 5 under the supplement, not supplanting requirement.

[82] As is further discussed in chapter 5, the matching requirement which this state passes through to the recipients as a one-for-one Federal-local match, requires poorer recipients which receive greater amounts of VEA funds to provide greater amounts of local matching funds.

Significantly, *other characteristics of state funding formulas*, such as the type, number, scaling and interrelation of formula factors, are independent of the issue whether the ultioutcome is a percentage reimbursement or a specific amount of VEA funds. Formulas with a variety of characteristics can be adjusted to calculate either one. With this in mind, we will return to the formula factors and work through how they are used to determine the final funding outcome.

b. *Scaling the factors* -- One of the first issues states have had to resolve in structuring their VEA formulas is, how to scale the factors; that is how to convert the raw numbers for each factor into a numerical value which can be used (1) to compare applicants on that factor and (2) to combine with other factors in the formula.

ED's model Formula 1 set out in the Federal legal framework, *supra*, ranked each factor by assigning one point for each standard deviation from the mean. One of our four states uses the standard deviation method to scale each factor. Another state ranks applicants on each factor and divides this rank order into *fourths (quartiles)*. For each factor a recipient can receive from 1 to 4 points, with one point being assigned to recipients in the quartile of least need and four points assigned to each recipient in the most needy quartile, on each factor.

A third state first assigns a point range to each factor, e.g., 18 to 27 points for RFA and 0 to 12 points for new programs; then ranks applicants on each factor; and finally, assigns points to recipients based on where they fall on the continuum within those point ranges.

None of these three states use a continuous point scale. A continuous point scale is one in which the range separating two applicants in points is proportional to their distance apart on the actual factor values. For example, if one LEA has 25% of its population that are low income and another LEA has 10% of its population that are low income a continuous point scale might assign the first LEA 2.5 points and the second LEA 1 point.

Discontinuous scales, on the other hand, have cut-offs which treat values on one side of the cut-off very differently than on the other side. For example, assume in the above illustration that the first quartile of applicants for the low-income concentration factor runs from 0% to 10% low income, and the second quartile runs from 10.01% to 20% low-income. The LEA with 10% low-income receives 1 point, and the LEA with 10.1% low-income receives 2 points in a discontinuous scale because it is in the second quartile. The use of a continuous scale here might assign the 10.1% LEA a point value of 1.1, rather than 2.

The fourth LEA in our study does not use a point scale to compare applicants on each factor. Rather, for a number of factors it compares the applicant's factor score to the state average score. For example, for relative financial ability it computes the ratio of the state average revenues per pupil to the LEA's revenues per pupil (State Average Revenues/LEA Revenues).[83] Thus, the factor is an amount that can be greater or less than 1 depending on whether the LEA is above or below the amount of state average revenues. An LEA at the state average would receive a score of 1. This is a continuous scale because applicant factor scores are proportionate to the actual differences in factor raw scores.

c. Relating the factors to each other so that some are given greater importance than others -- ED's "model formula" suggested three methods for giving greater individual weight to the two required fund distribution factors than to any others. One method was to multiply the points calculated for the RFA and low-income/higher cost student factors by some number, *e.g.*, by 2 as suggested in Model Formula 1. A second method was to create point scales that assigned a wider range of points to these two factors (Model Formula 2). The third method was to have each factor govern the distribution of a specific proportion of total VEA funds allotted and to have the two most important factors govern a larger share of the funds than the other factors, *e.g.*, the RFA factor is used to distribute 35% of total funds while the new program factor only allocates 10% (Model Formula 3).

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[83] This state was authorized to use a revenue measure of RFA. *See* chapter 3 at p. 29.

The four states in our study used some of these methods for varying the importance of the factors, as well as another method. Several states use a variant of Model Formula 3. They separate the factors and use each factor to allocate a specific proportion of total VEA funds. In a simplified version, the formula for the LEA Allocation is as follows:

$$\text{A Recipient's Allocation} = \text{Total State VEA Allotment} \times [30\%(\text{Low-Income Factor}) + 39.9\%(\text{RFA Factor}) + 29.99\%(\text{Vocational Education Participation Factor}) + .1\%(\text{EDA Factor}) + .1\%(\text{New Program Factor})]$$ [84]

The percentages represent the percentages of the state-wide total allotment that is distributed by each factor. Greater importance is given to the RFA and low-income factors by having them govern a greater percentage of the total amount allotted than any other individual factor.

One state sought to give greater importance to the low-income and RFA factors by assigning them each a range of 18-27 points and by assigning the following point ranges to other factors: EDA 0-18; New Programs 0-12; and ADM 4-16. Another state, which uses a quartile scale of 1-4 points for each factor, assigns an additional point to each of the two most important factors. For example, if an LEA receives 3 points for being in the third RFA quartile, one additional point is given for RFA for a total of 4 points. This is true for each LEA; that is,an LEA in the first RFA quartile would receive 1+1 = 2 points.

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[84] In this formula, each factor computation determines both the relative factor score in comparison to other LEAs and the amount of total VEA funds allotted by that factor to which the LEA is entitled.

Once the point totals are determined for each factor, they are often combined to give a total point score for each applicant. Three of the states in our study totaled the points for each factor to arrive at a point total for each applicant. The fourth state, whose formula is described above, does not calculate an applicant's point total since it, in effect, applies each factor individually to a specific percentage of the VEA funds in the formula.

d. The use of total points or other total factor scores to allocate VEA funds -- The three states which total the points for all factors then must translate those point scores into VEA funding amounts and/or recipient matching percentages. As described in the introduction to this section,these three states use the general VEA formula to calculate specific amounts of VEA funds or other variable percentages of recipients' vocational education costs that VEA funds will pay for. These states use several different methods for doing this.

Under one method states allocate VEA funds by comparing a recipient's total points to the total points for all recipients; and this percentage is used to determine the amount of VEA funds the recipient will receive. For example, if the total points for all recipients is 100, and a particular LEA has a total of 10 points, the LEA would be eligible to receive 10% of the total VEA funds allocated under the formula.

The fourth state, which does not use point totals to allocate VEA funds, has created a formula which results in the calculation for each recipient of a percentage of the total VEA funds in the formula which will be allocated to a recipient under each factor. This state uses the additive formula described generally at p. 60, supra. The percentages of the total VEA funds allocated by each factor are then totaled to determine the percentage of the total VEA funds each recipient will receive. For example, this can be expressed for a hypothetical LEA as:

LEA Entitlement = Total State Allotment for all LEAs [2% for Low-income Factor +

1% for Vocational Education Participant Factor + 3% for RFA Factor + .12% for EDA Facto

+ .08% for New Program Factor][85]

When all of these percentages are totalled the LEA is entitled to 6.2% of the Total State Allotment for all LEAs.

Where total points are used to calculate a percentage reimbursement, applicants are frequently ranked on total points, and then this ranking is divided into groups of recipients, each of which is entitled to receive a different percentage of total costs from Federal funds. For example, one state uses recipients' total points to develop recipient quartiles. Each of the four recipient groups is required to provide a different percentage of local matching funds, in this case between 26% and 32%.[86]

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[85] A factor for number of students enrolled by each recipient or other measure of recipient size is included as a multiplier in the calculation of each factor.

In some of these states, formula amounts were initially calculated as "preliminary entitlements" of which potential applicants were notified prior to submitting applications for VEA funds. These preliminary entitlements formed the basis for recipients to prepare applications.

When applications are actually received, formula amounts are recalculated based on applications actually submitted. If the total amount available is not fully allocated under the formula, e.g., because some applicants do not apply for the full amount to which they are entitled, the unallocated amount is distributed either by formula or by project application.

e. How states incorporate recipient or program size into formulas -- As described in the Federal legal framework, supra, the VEA prohibits states from allocating VEA funds "on the basis of per capita enrollment," and ED has had to interpret how this prohibition affects the use of measures of recipient or program size, such as numbers of students enrolled in a recipient's vocational education program.

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[86] This type of variable local share calculation is also frequently used with the project method of funding, described in section IV infra. at page 100.

One state, pursuant to ED's Model Formula 3 (supra, p. 46) has an element in its formula which allocates a portion of VEA funds on a flat grant per student. The state, however, does not otherwise take into account the size of the recipient's enrollments in allocating VEA funds. Nor is another unit of size, such as a number of teachers, used to allocate these funds. This occurs because this state was encouraged by ED to use Model Formula 3 which uses pure factors without any service unit multiplier to allocate funds. For example, assume two LEAs have the same demographic characteristics as measured by the VEA formula factors, but one has only 100 pupils while the other has 1000 pupils. We will assume that both have the following factor points:

25 for Low-income Families
20 for Relative Financial Ability
15 for EDA
+ 5 for New Programs
65 TOTAL POINTS

As calculated in this formula, all four of these factors ignore differences in the enrollments of the two LEAs. A fifth factor for ADM (average daily membership) does take this into account. This factor has a range of from 4 to 16 points. Assuming the smallest LEA received 4 points and the largest 16, the total point scores would be 69 points (65 + 4) for the LEA with 100 students and 81 points (65 + 16) for the one with 1000 students. As a consequence of this formula, the largest LEA with ten times the number of pupils receives only about 17% more VEA funds. This means that if the smaller LEA receives $100 per student

($10,000 total), the larger would receive a total of $11,700 or only $11.70 per student even though the LEAs have the same demographic factor scores and differ only in their enrollments.

Other states do take into account the variation in the number of students or the variation in other measures of recipient or program size, e.g., teachers, equipment, or total costs. One state takes recipient enrollments into account by using vocational enrollment as a multiplier in the formula to arrive at total points for a recipient. If we use the above example, this would have the effect of multiplying the total points for the four factors (65 points for both LEAs) by 100 for the smaller LEA and 1000 for the larger LEA (assuming here that these represent vocational enrollments). This would give the smaller LEA 6,500 points and the larger one 65,000, which makes the amounts of VEA funds available to these similarly situated LEAs proportional to their number of pupils enrolled in vocational education.

Another state takes into account differences in the size of LEA programs by using the formula to reimburse LEAs for a variable percentage of the approved salaries of each LEA's vocational education staff (which presumably are in rough proportion to enrolled students)87/.

Another state, which does not use a point system, has a pupil or other multiplier for applicant size as part of each of its factor calculations. This state uses both total

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87/ The project method is another method for seeking to make VEA allocation correspond, at least roughly, to the varying size of vocational programs among applicants. This is discussed later in this chapter in section IV, at p. 100.

students in attendance in grades 9-12 and students enrolled in vocational education as multipliers for different factors.

4. The Range of Variation in the Percentage Match of Local Expenditures

As described in the Federal legal framework, the statute prohibits the use of a "uniform percentage basis" for "matching of local expenditures"; in the case of new program funding, the VEA prohibits states from denying funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."[88] Consequently, where states use a percentage reimbursement method to translate factor totals into VEA and matching percentage shares, we examined the range of variation specified in the formula.

In one state, the formula calculated a local percentage matching amount of total calculated costs that ranged from 26% to 32%. In another state, which uses the formula to reimburse LEAs for a percentage of staff salaries, the total point spread from highest to lowest need LEA was reported to be from 11 to 24. This translates into a percentage reimbursement which is dependent on the amount of VEA funds budgeted and approved, and total salaries used to calculate reimbursement; however, irrespective of the specific percentages, the range in percentages is, at a maximum, a little more than 2 to 1.

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[88] Section 106(a)(5)(B)(ii) of the VEA (20 U.S.C. 2306(a)(5)(B)(ii)

Another state, which allocates VEA funds as a specific entitlement without regard to reimbursement of local expenditures, also uses RFA and low income/higher cost students factors to calculate maximum Federal support levels, e.g., the remainder of funds are local matching funds. Recipients are ranked on these combined factors (without a student multiplier) and the top 10% of eligible agencies are assured a higher maximum Federal support level than the middle 80% of agencies and the bottom 10%. Generally, the range in maximum Federal support levels (and local match) is either 10% or 20% from the top to bottom group in the ranking, e.g., from 40% to 60% maximum Federal support levels is a 20% range.

5. Information States Report on Formulas

We reviewed both five-year state plans and annual program and accountability reports for the states in our study. All states provided some description of their formulas and the definition of the factors used. In a number of cases many definitions of elements in the formulas were missing and formulas could not be fully understood without interviewing state officials.

State reports provided total amounts of VEA funds allocated to each recipient. One reported these allocations on a per pupil basis. Most did not give examples of how the formulas actually operated to produce specific allocations for particular LEAs and postsecondary institutions.

D. Findings, Conclusions and Recommendations

This policy analysis considers the clarity, consistency and adequacy of the VEA legal framework pertaining to the design of formulas for states to use in allocating VEA funds among eligible recipients. In this analysis the focus is on whether the formula design requirements carry out the congressional objectives made clear in the 1976 VEA amendments, as well as in earlier amendments, i.e., that VEA funds should be allocated among recipients according to their need for these funds as measured particularly by their relative financial ability and their concentration of low-income persons or higher cost students.

This analysis is also mindful of the congressional intention to give priority in application approval to applicants proposing certain new programs and located in economically depressed areas.

In the introduction to this chapter the issues that are inherent in the design of funding formulas - for VEA or any other sources of funds - were described. Of these issues, the following are analyzed in this section:

- The Number and Types of Formula Factors

The use of the funds distribution factors was analyzed in Chapter 3. Here we continue the discussion of Chapter 3, as well as the Chapter 2 analysis concerning the appropriateness of the use of the application approval priorities (new programs and EDA) in the formula. We also consider the inclusion of additional formula factors and introduce the issue of how to take into account the varying enrollments or other measures of recipient size in funds distribution formulas.

- The Scaling of Formula Factors

This section applies the discussions contained in chapters 2 and 3, concerning the definition and measurement of application approval criteria and funds distribution factors, to the formula design requirements. It considers how decisions about the scales to use for determining the variation among applicants on each factor can affect the outcome of formulas.

- The Relationship of the Factors to Each Other so That Some are Given Greater Importance Than Others

Under the issue of how to weight formula factors, we consider the requirement that the funds distribution factors of RFA and low-income/higher cost students be the two most important factors in funds distribution, and the adequacy of the legal framework to ensure this. This analysis considers this issue in the context of ED's interpretation that application approval priority and fund distribution factors can be combined in a single formula.

- The Use of Scales to Determine VEA Funding Amounts

As described in the introduction, at least two scaling decisions must be made in designing VEA formulas: the first, introduced above, is how to scale each formula factor to account for variation in the factor among recipients and relate that factor to other factors in the formula. The second, considered in this section, relates to scales or computations used to translate the numerical values generated by the formula into the amount of VEA funds each recipient is to receive. This section will further consider the use of numbers of students or other measures of the size of recipients or their programs in making this calculation.

These issues will be considered here in terms of general formula design requirements and their application in general. In section IV of this chapter these issues are further considered as they are applied to various uses of VEA funds, e.g., funding pools, set-asides and project method of funding.

In general, we have found that the Federal legal framework has been unclear concerning these formula design requirements, and that some of ED's interpretations concerning the design of formulas have been inconsistent with the congressional objectives the VEA funds distribution requirements were intended to further. In addition the statute and ED's interpretations do not establish a legal framework sufficient to address all of the issues that are essential to consider in designing a VEA funds distribution formula; and the framework for designing formulas has been made needlessly complex. Our recommendations made in this section are intended both to simplify the legal structure and ensure that VEA formulas carry out the objectives Congress intended, while at the same time affording the state substantial flexibility in addressing particular vocational education needs.

1. The Number and Types of Formula Factors

a. The inclusion of the two application approval priorities as formula factors -- As described in the Federal legal framework above and in chapter 2, ED has interpreted the VEA to require that states' VEA formulas contain both the application approval priorities (new programs and EDA), and the two required fund distribution factors (RFA and low-income/higher cost students) if the state uses a so-called "one-step formula". In chapter 2 we concluded that inclusion of the two application approval criteria as formula factors did not give them the priority Congress intended. Their inclusion also has a reciprocal effect on the required fund distribution factors: it tends to dilute and confuse the effect of the required fund distribution factors.

This dilution is of particular significance because, as discussed in chapter 2, the application approval criteria of new programs and economically depressed areas are not appropriate concepts for determining the amount of funds recipients should receive and/or lack appropriate recipient-specific measures. These factors may be appropriate for use in approval of applications, *e.g.*, for creating a funding pool for new programs, but their inappropriateness as funds distribution factors tends to undermine the intended effects of the two fund distribution factors. We found frequent agreement among state officials on these conclusions.

Not only does their use as fund distribution factors dilute the other appropriate factors, but it also makes it virtually impossible to predict the distributional effects of VEA funding formulas. As considered in Chapter 3, we have concluded that the RFA and the low-income persons/higher cost student factors, if properly measured, are appropriate for carrying out congressional intent in the distribution of VEA funds. The application approval criteria, when turned into funding factors are not.

In contrast, we agree with ED's interpretation of how the two required fund distribution factors should operate in a "two-step" process. In a two-step process application approval priorities are used to select applicants for funding (step 1) and then the two fund distribution factors are used in a formula to determine the amounts approved applicants will receive (step 2).[89] In this case the formula is not confused by inclusion of application approval criteria.

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[89] It is important to note that we have concluded that ED's interpretation of how the new program and EDA criteria are to function in step 1 of a two-step formula is incorrect. Under this interpretation these factors are to be given mathematical values which are used to rank recipients to determine eligibility for funding. Our conclusions concerning the inappropriateness of using these factors as mathematical variables applies to this process as well, and this is particularly the case for new programs. If the objective is to fund new programs, applicants should be required to apply for funds from a funding pool for new programs, which can only be used for new programs. See Chapter 2. Fund distribution factors should then be used to determine the amounts of VEA funds each approved applicant's new programs will receive. In our view, step 1 is simply the application approval process which includes state-imposed program parameters *e.g.*, funds shall only be used for particular purposes, such as new programs, handicapped programs, or replacement of obsolete equipment.

An additional reason for not including the EDA application approval priority in the formula is that the Senate, which proposed this priority, appeared to view this priority as having the same objective as the fund distribution factors proposed by the House Bill. Both sought to provide additional VEA funds to recipients that had greater needs for vocational education programs and diminished financial abilities. This was particularly true of the EDA priority which the Senate saw as a need and fiscal ability indication, much as the House viewed the required funds distribution factors. While the intent of the EDA priority is thus redundant, its inclusion as a factor in VEA formulas has actually detracted from the objective it was intended to accomplish, because of serious measurement and data problems.[90] It is our conclusion that in the fund distribution process the objective for including EDA as an application approval priority is better accomplished by not using it as a fund distribution factor. Consequently, we recommend that Congress clarify that the application approval priorities of section 106(a)(5)(A) may not be used as fund distribution factors.

b. The inclusion of additional formula factors -- At present, the VEA does not explicitly limit the number of factors that can be included in a formula so long as they are "economic, social [or] demographic".[91] As described in the Federal legal framework, ED's Task Force Report stated that some states had created extremely complex formulas, with eight, ten, or more factors, with some factors using multiple indicators.

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[90] *See* Chapter 2 at p. 21.

[91] Section 106(a)(5)(B) of the VEA (20 U.S.C. 2306(a)(5)(B)).

It also correctly pointed out that adding more factors dilutes the effects of each factor. The net result of such dilution is to flatten the distribution. The most factors we found in the formulas of our study states was seven; however, several states used multiple measures for single factors, e.g., one state uses both LEA property wealth per pupil and state aid per pupil as measures of RFA in such a way that these two components cancel each other out, to give each applicant approximately the same RFA factor.

Even if application approval criteria are not permitted to be used as funding factors, the present structure would still permit others to be included. As noted by the ED Task Force Report, this could defeat the funds distribution objectives by cancelling out the effects of the two required funds distribution factors. Our interviews with state officials indicated that ED had sought to discourage states from including factors in addition to the two fund distribution and two application approval priorities specified by statute.

We agree with ED's objection to the inclusion of additional factors. The addition of factors is a major way that a formula can be manipulated to defeat intended distributional objectives. For example, the simple addition of a factor for the amount of a recipient's state aid per pupil could cancel out other valid relative financial ability measures such as property wealth per pupil or total state and local revenues per pupil.

We recommend that VEA formula factors be limited to the two now required by statute: for LEAs, RFA and low-income persons; for OERs, RFA and higher cost students. The use of only two factors will ensure the funding focus Congress has long intended, and will also make formulas simpler and more predictable in effect.

This recommendation will not decrease state flexibility in the use of funds; indeed, in conjunction with other recommendations, states will have greater flexibility. Our other recommendations include that states be permitted to use measures of the RFA factor that they use in their own general aid to education formulas[92], and that states be permitted to override the allocation determined by formula based upon other objective criteria of relative recipient need for vocational education services equipment or facilities (discussed later in this section).

c. The proper inclusion of a factor for the size of recipient vocational education programs -- Several states we studied include as part of their formula a factor which generates a flat amount per pupil for each recipient. These flat grant components operate as "additive" factors, that is, they function in isolation from other factors in the formula.[93] ED has been inconsistent concerning the status of such factors. The September, 1979 Draft Manual stated that "flat funding levels within VEA formulas" are prohibited, interpreting the statutory prohibition in allocating funds on the basis of per capita enrollment.[94] The same draft, however, included a model formula (Model Formula 3)[95] which contained an additive factor for ADM (average daily membership) which allocated funds to recipients as a flat funding level per pupil. This is the same general formula which ED recommended to one of our study states. In another state, we were informed that ED had urged the state to use the number of pupils as a multiplier to be used with a recipient's total factor score.[96]

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[92] See Chapter 3 at p. 37.

[93] An example of a formula using additive factors would look as follows: Total points = .40 (RFA factor) + (low-income factor) + .20 (pupil enrollment factor). In this example, pupil enrollment is an additive factor that governs 20% of the total points for recipients and 20% of the funds allocated statewide under the formula.

These conflicting interpretations appear to result from ED's uncertainty about how to include a unit in a formula which takes into account the size of a recipient's vocational education programs (*e.g.*, number of students, teachers, value of equipment) and give meaning to the prohibition on allocating funds on the basis of per capita enrollment.

This resulted in ED recommending or accepting Model Formula 3, which totally ignores the size of a recipient's vocational education program or the need for a program in terms of numbers of persons who could be served -- except by including a small flat grant per pupil as an additive factor.[97]

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[94] BOAE/DSVPO Draft Manual on Federal Fund Distribution Procedures, Sept. 1979.

[95] *Supra*. at p. 46.

[96] Later draft manuals appeared to encourage, but not require, states to use number of students or other factors for recipient or program size as a multiplier in VEA formulas. *See supra* pp. 48-50.

[97] The operation of Model Formula 3 is discussed in the Federal Legal Framework in this chapter, *supra* at p. 46.

In contrast, it is well accepted in the discipline of school finance that finance formulas must include the size of a recipient's program or potential program as the foundation of a rational allocation plan.

A variety of measures can be used in the funding of vocational education to indicate the size of a recipient's program or potential program. One common measure is the number of students enrolled in vocational education (often standardized for purpose of comparison by full-time equivalent or contact hours). Another is the number of teachers or amount of salaries of teachers. For some purposes, such as replacement of obsolete equipment, the value of such equipment may be the measure used. Where a state wishes to encourage recipients to make vocational education available to more students, it may measure the potential need for services by the total number of students enrolled by the recipient.

When these size factors are properly used in a formula, recipients that have equal needs, as measured by factors such as RFA and low-income, receive funds under the formula in proportion to their relative size. For example, an LEA with 1000 students enrolled in vocational education would receive $100,000 and one with 100 students would receive $10,000, but both receive $100 per enrolled student - assuming both have the same RFA and low-income factor scores.

It has not been clear under the VEA legal framework how the size or potential size of a recipient's vocational education program could be taken into account without violating the prohibition on per capita distribution. As discussed above, these are very different concepts. We recommend that Congress clarify that there is no conflict between them. We further recommend that in applying the fund distribution factors, states be required to take into account the size or potential size of a recipient's vocational education program.

There are many methods available to states to do this; e.g., use of a pupil multiplier with total formula factor scores or variable percentage reimbursement of teachers' salaries. We see no reason at this time, however, to constrain state choice as to the method, except to prohibit additive size measures such as contained in ED's Model Formula 3.[98]

2. The Scaling of Formula Factors

The VEA is silent on how formula factors are to be scaled. The scale referred to here is that which is used to convert the raw factor numbers into other numerical values which are used to compare applicants on a particular factor and which, in some types of formulas, are used to combine the variables with other factors in a formula.

An example of the type of scale we are discussing here is as follows: In a particular state, LEAs may vary from $100,000 per pupil in property wealth to $10,000 per pupil, with a mean value of $50,000, a ratio of 10 to 1, top to bottom. These are the "raw numbers". To use this factor in a formula, a state may wish to convert these values to points. To do this, it must develop a scale of points. It could, for example, create a scale of from 1 to 10, which is proportional to the variation. It could, however, compress the variation by using a scale of from 1 to 3, by dividing the LEAs into thirds, based on their rank on the RFA factor. In both cases the wealthiest LEA receives 1 point. However, in one case the poorest LEA receives 10 points and in the other only 3 points.

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[98] See p. 46 , supra.

There is no reason the scale must begin at 1. In this situation the scale could run from 100 to 110, with the wealthiest LEA receiving 100 points to the poorest's 110 points.

ED has not directly dealt with this scaling issue except to give examples of different scales in its "model" formulas. However, the consequences of these scaling decisions can be dramatic. This is based upon the fact that variation in a scale is not determined as much by the absolute size of the numbers, as by the ratio or percentage variation among the numbers. This is simple to illustrate. In the first example above, the scale of 10 to 1 is proportional to the range of variation in the basic factor. In the second example the 10 to 1 variation has been reduced to 3 to 1 by a scaling decision and in the third example the 10 to 1 variation (a 1000% variation) has been reduced to a 10% variation - a hundred fold reduction - which renders the factor nearly meaningless since all LEAs receive virtually the same score.

Some states have played this scale "game" with skill to diminish the variation in VEA allocations resulting from factor variation. For example, one state uses high minimum scale numbers to reduce the variation, i.e., on RFA the wealthiest LEA receives 18 points and the poorest 27. This is akin to the 100 to 110 variation in the example above. This state seeks to give greater importance to the RFA factor by increasing the total numbers, when in fact the opposite occurs. New programs, in contrast, is scaled from 0 to 12, which gives the new program factor greater power as a ratio (1200% compared to 50%) and in absolute numbers (12 compared to 9).

Another state gives "greater importance" to the RFA and low-income/higher cost student factors by adding +1 to their values. The scale is based on quartiles where applicants are ranked on each factor and assigned a number for each factor of from 1 to 4. Without the addition of the +1, the difference between the most and least needy applicants is 4 to 1. When +1 is added this is reduced to 5 to 2 or 2.5 to 1. Thus, the addition of the +1 actually reduces the importance of these factors.

Another scale which is used by states and appears in ED's Model Formula 1, is the standard deviation scale. As described in the Federal legal framework, supra at p. 43 this gives one point for each standard deviation from the mean, when this is calculated for each factor for all applicants. In ED's model, 5 standard deviations below the mean was assigned 0 points and 5 standard deviations above the mean was assigned 10 points, making an 11 point scale. This, at first glance, appears to be a wide variation.

However, the characteristics of a standard deviation statistic reduce the actual variation substantially and move the distribution toward a flat grant, irrespective of the actual variation among recipients in each factor. This is because the concept of standard deviation is one that by definition normally includes about two-thirds of all the units measured (here LEAs) within one standard deviation of the mean, and about 95% within two standard deviations of the mean. This means that about two-thirds of all of the LEAs on any factor would receive scores in the range of 4 to 6 and about 95% would be within the range of 3 to 7. Thus, regardless of actual variation in the factors, the variation in the scale for most applicants does not exceed 1 to 1.5 (4 to 6).

Some states use scales that are directly proportional to the value of the raw factors. For example, one state measures an applicant's RFA as average state and local revenues per pupil. Here if the state average is $1,000 and an applicant has revenues of $2,000 per pupil, its factor value for RFA is .5 ($1000/2000). An applicant with revenues of $500 per pupil would have a factor of 2 ($1000/500). Thus, there is a 4 to 1 range in both the basic RFA values and the factor scale for RFA.

A second type of problem also was apparent in the creation of factor scales by states. This is the use of discontinuous scales. The difference between a discontinuous and continuous scale was described in the state legal framework.[99] Basically a discontinuous scale only recognizes discrete points and not differences between them, e.g., assigning applicants having $10,000 to $30,000 property wealth per pupil 4 points and those with $30,001 to $50,000 per pupil, 3 points. Here the applicant with $30,000 property wealth receives 4 points (the same as the $10,000 applicant) and the one with $30,001 receives only 3 points. The difference in point value is wholly disproportionate to the actual variation. Some states, in contrast, use continuous scales. A continuous scale in this example would give 4 points to applicants with $10,000 in wealth, 3.5 points to those with $20,000 wealth and about 3 points to the applicants with $30,000 and $30,001 in wealth. Continuous scales are not difficult to create.

We found the scaling problems identified above to compound other problems in the VEA such as the use of application approval factors in the formula. The scaling problems described above necessarily reduced the variation within the formula and added an element of caprice to the variation that existed.

Consequently, it is our conclusion that if Congress intends that eligible recipients receive substantially different amounts of VEA funds based on differing needs and financial ability as reflected by the fund distribution factors, it should add a provision to the VEA that puts parameters on how these factors are scaled.

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[99] See supra at p. 58-59.

First, we recommend that continuous scales be required. As described in the analysis above and in the state legal framework section, discontinuous scales distort the disparities so that virtually identical applicants are treated very differently. Second, we recommend that parameters be placed on factor scales to ensure that there is a substantial correspondence between the ratio of variation of each fund distribution factor and the ratio of variation of the numbers used to scale each factor. As described above, the use of scales which substantially reduce the variation of factors among applicants can undermine the objectives of allocating funds on the basis of indicated need by making the final outcome close to a flat grant.

We specifically recommend that a scale parameter be based on the ratio of variation in the unscaled fund distribution factors (RFA, low-income and higher cost students). For example, if the RFA factor (assessed property valuation per pupil) ranges from $100,000 per pupil to $10,000 per pupil, a ratio of 10 to 1, the point scale for this factor would have to be 10 to 1 or greater.100/

Other parameters could be selected which would ensure substantial, although not complete, proportionality between factor

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100/ This parameter would permit the state to use any point scale so long as the ratio is maintained, *e.g.*, a scale ranging from 4 to 40 would be equally acceptable.

and scale variation. For example the extremes of the variation could be disregarded in computing the ratio. That is, the minimum scale ratio could be based on the factor ratio between the applicants at the 5th and 95th or the 10th and 90th percentiles in the factor ranking.[101] Another option would require proportionality based on the full range or selected percentile range of variation up to a maximum ratio, e.g., 5 to 1. Such a maximum would help to ensure that one of the two funding factors is not given substantially more power in the formula than the other simply as a result of a wider or substantially different scale.[102]

Such a parameter has the advantage of making the scales for the factors in each state appropriate to the disparity within the factors in each state. For example, a state whose LEAs did not vary substantially in their relative financial abilities could use a narrower scale for its RFA factor than a state whose LEAs vary dramatically in RFA.

In many formulas the points for each factor are combined to obtain a point total for each recipient and for all recipients in the states. We have recommended above that formulas contain only the two required fund distribution factors. In combining the points from the scales for these two factors, we recommend that parameters similar to those for the individual factor scales operate to govern their combination. A parameter on factor combination is needed because the simple addition of a constant value to the factor totals can render the individual factors largely irrelevant. For example if both the RFA and low-income factors have scales that run from 1 to 4 points, when combined, the maximum variation is from 2 to 8 points, which maintains the same ratio difference as the individual factors. However, the addition of a constant, e.g., the number 100, to the totals, converts the final values from 102 to 108 - a virtual flat grant. Consequently, we recommend that Congress add a parameter on the ratio of factor difference when both fund distribution factors are combined. A possible parameter is that the ratio of lowest to highest possible combined factor score be, at a minimum, not less than the average ratio of the individual factor ratios.[103]

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[101] In the example above of a 10 to 1 ratio based on highest and lowest applicant in property wealth per pupil, the applicants at the 95th and 5th percentiles on the factor might have property wealth per pupil of $80,000 and $20,000 per pupil, a ratio of 4 to 1.

[102] This could otherwise occur based on the principle discussed above that the power of a factor is determined by the ratio difference of its scale more than by the absolute numbers of its scale. Increasing the absolute numbers in a scale tends to reduce the variation of all factors in the formula, e.g., a scale of 1 to 4 produces a greater variation than one that runs from 100 to 104. However, if the two scales are combined so that total values can run from 101 to 108, the scale with the larger numbers has turned the distribution into a virtual flat grant.

3. Relating the Factors to Each Other So That Some are Given Greater Importance Than Others

The issue of how much weight to give an individual factor when combined with other factors is one to which ED has devoted substantial attention in order to give meaning to the requirement that RFA and low-income (for LEAs) or higher cost students (for OERs) are the "two most important factors" in determining the distribution of VEA funds.[104] Much of the need for this interpretation flowed from ED's interpretation that the new program and EDA application approval priorities be included in a "one step" funding formula along with the required funds distribution factors. In combining them, ED had to ensure that the required funding factors were most important.

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[103] For example, if the RFA ratio is 1 to 4 and the low-income ratio is 1 to 2, then the average ratio is 3 to 8.

Several states, in seeking to comply with the "most important" factor standard, actually gave less importance to the required factors. For example, as described in the previous section on scaling, one state sought to give RFA greater importance by increasing the absolute numbers in the RFA scale so that the RFA scale ran from 18 to 27 in comparison to the New Program scale that ran from 0 to 12. As discussed above, this had the effect of making the RFA factor less important than the new program factor. The same result occurred in another state which added +1 to the values of scales for the required factors. In both cases, by increasing the absolute numbers of the scales, the ratio of difference of the scales was reduced, thereby diminishing the importance of the factors. The problems of factor weighting have arisen largely because of the inappropriate, but required, inclusion of application approval factors in VEA funds distribution formulas and the lack of any limitation in the VEA on the number of formula factors. Dealing with these problems, as we recommend, will eliminate most current problems relating to factor weighting. However, if Congress continues to permit additional factors, the issue of how to give greater importance to the two required fund distribution factors will remain. Part of this remaining problem would be addressed by the ratio parameters for the formula factors as described in the preceding section. Ratio parameters would avoid the diminished importance of factors resulting from inappropriate choice of factor scaling. There are other ways, however, to change the importance of factors in a formula, and monitoring the individual importance of factors becomes more difficult as the number of factors in the formula increase. We make no additional recommendations about other specific parameters to prevent possible problems if the number of formula factors is not limited. We believe these would have to be reviewed on an individual basis.

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[104] Section 106(a)(5)(B)(i) of the VEA (20 U.S.C. 2306(a)(5)(B)(i))

4. The Use of Scales to Determine VEA Funding Amounts

In the state legal framework are described some of the methods states use to translate total points or other formula calculation into the amount of VEA funds recipients will receive. Typically, formula totals are used to calculate the specific amount of VEA funds a recipient is entitled to receive or the percentage of certain costs that VEA funds will reimburse.[105/] The use of scales or other calculations to determine the amounts of VEA funding each eligible recipient will receive after fund distribution factor amounts have been calculated and compared

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[105/] A third general method, the project method, which can combine these features, is discussed in section IV of this chapter.

can be the most important step in a formula. Inappropriate decisions made at this stage can destroy the effects of a fund distribution formula that would otherwise appear exemplary.

Although the VEA contains prohibitions on per capita distributions and uniform percentage matching, these issues have been largely ignored by ED's interpretations. As best we could ascertain from interviews, ED has taken the position that as long as a formula avoided distributing funds solely as a flat grant per pupil or solely on a uniform percentage basis, these provisions were met.[106] ED's most recent interpretation is that states may not allocate funds "solely on the basis of per capita enrollment".[107] Both Houses of Congress in the legislative history to the 1976 amendments indicated that they felt strongly about these provisions, finding states had tended to allocate VEA funds as flat amounts in the past, and exhorted ED to enforce them vigorously.

We found, however, that ED did not consider these provisions to be sufficiently specific to do more than prohibit the most flagrant examples of flat grants or uniform percentage reimbursements. We were informed by one state that ED had refused to approve a percentage match that "varied" from 49% to 51%, but had also refused to specify the amount of variation that was required.

106/ At one time a Draft Manual on funds distribution stated that a "flat minimum funding but may not be built into the formula", but this same document described a "model" formula which did so BOAE/DSVPO Draft Manual on Federal Fund Distribution Procedures Sept. 1979 at 13.

107/ OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

We did not conduct an empirical analysis of the distributional effects of VEA formulas in the states we studied. We did, however, examine formulas for their equalizing potential for addressing differences among recipients particularly in RFA and concentrations of low-income/higher cost students. We also inquired in state interviews about the states'objectives for the formula. In some states at least, such equalization was not viewed as a high priority in the allocation of VEA funds.[108] We also found that some of the formulas we reviewed had been designed, intentionally or unintentionally, in a way that circumvented these objectives and, in operation, would of mathematical necessity tend to allocate VEA funds in a manner that is close to a flat grant or uniform percentage reimbursement. For example, some states use the point totals from the formula to determine variable percentage reimbursement or local matching rates for recipients. The variation in these rates bore little relation to the variation in the total factors in some cases. Rather, the total formula scores were used to rank recipients and reimbursement or matching rates having little variation were assigned to recipients that were at various points in this ranking scale. For example, in one

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[103] We found some notable exceptions, e.g., one state used the low-income factor to equalize for varying concentrations of low-income persons to a greater extent than would be required under the parameters recommended here.

state the variation in local match was 26% to 32%. In other words, the most needy LEA had to contribute 26% of total costs and the least needy had to provide 32% -- a variation of only 15% in the local match. Other states also have little variation in the percentage reimbursement and matching requirements.

We noted fewer problems in this regard in formulas that directly allocate VEA funds to recipients, i.e., those that do not use a variable reimbursement percentage or local match. The major problems of these direct allocation formulas appeared to be in the selection and definition of factors and factor scaling. Once the factor totals for these formulas were calculated the amounts of VEA funds allocated tended to be proportional to these totals. This is not, however, inherent in direct allocation formulas. If opportunities for reducing the degree of variation through formula selection and scaling are closed off, some states may seek to create scales that reduce the proportionality of factor totals to fund allocations.109/ Thus, the recommendations that follow apply to both percentage reimbursements and direct allocations.

109/ For example, a state could create a direct allocation formula that, similar to a percentage reimbursement scale ranks recipients on total points, divides the ranking into groups, and allocates a specific amount of VEA funds per student to recipients in each group. A state that wished to reduce the variation might divide the ranking in thirds and allocate (hypothetically) $60 per pupil to the least needy third, $65 per pupil to the middle third, and $70 per pupil to the most needy third.

It is our conclusion that if Congress intends that VEA funds be used to equalize for differences in RFA and low-income/higher cost students among recipients, the Act must be clarified to give greater precision to the VEA requirements prohibiting per capita grants and uniform percentage reimbursements. The methods we recommend to accomplish this relate directly to the manner in which formulas are used to calculate the amounts of VEA funds recipients are to receive.[110]

To ensure that VEA funds are allocated to recipients in proportion to their differences in financial ability and need for vocational services as shown by the RFA and low-income/higher cost student factors, we recommend that ratio parameters be placed on the scales used to allocate VEA funds or, if a scale is not used, then on the final allocation of VEA funds.

This ratio would not be calculated on the individual fund distribution factors, but rather would be determined by comparing the formula total of the eligible recipient with lowest VEA formula calculation to the formula total of the eligible recipient with the highest formula calculation. This ratio of lowest to highest formula totals would establish the minimum ratio of variation for the amounts allocated to the lowest to highest scoring recipients (in the case of a direct allocation formula) or the lowest to highest percentage reimbursement (in the case of a percentage reimbursement method).[111] An example of how this ratio parameter would operate is as follows: assume that the range of total formula points for applicants is from 20 to 5 from the most to the least needy. This is a ratio of 4 to 1. A percentage reimbursement with a variation of from 20 percent to 80 percent would meet the test. If the state used a direct allocation formula a variation in per pupil allocations of from $50 to $200 would also meet it.

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[110] The recommendations made in prior subsections such as those concerning limiting the number of factors and factor scaling are necessary foundations for the recommendations made here.

Our analysis of the formula in the four study states indicates that most of them have formulas whose mathematical properties would already meet this test. We observed both direct allocation and percentage reimbursement formulas that allocate VEA funds in direct proportion to the scores of recipients. Thus the concept underlying this parameter is well established in existing practice.[112]

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[111] In the case of percentage reimbursement, this ratio parameter must operate on the percentage of VEA funds provided and not on the percentage of local match required. The reason for this is simple to illustrate. If this ratio parameter operated on the local matching percentage a virtual flat grant could be permitted. Assume the ratio of variation in total formula points is 3 to 1. If this were applied to the local match it would permit a variation in the local match of from, for example, 1% to 3% local match which would permit VEA funds to reimburse recipients for from 97% to 99% of costs - a virtual flat grant. When the ratio parameter is applied to the VEA reimbursement percentage, it operates in the same manner as when this parameter is applied to a direct VEA allocation, i.e., both govern the proportion of VEA funds recipients receive. This is consistent with the purpose of the VEA formula which is to determine the distribution of VEA funds.

[112] It is important to distinguish between the concept of proportionately in present state formulas and whether the simple fact of proportionality is sufficient to ensure that the formula accomplishes intended objectives. As described in earlier analysis, some of these formulas with proportional outcomes include inappropriate factors or scales so that the net effect of this proportionality appears to be either capricious or negligible, because the formula was inappropriately designed at an earlier stage. This illustrates that all of the issues considered in this section are interrelated and cannot be addressed in isolation.

This parameter of proportionability between factor scores and the actual allocation of VEA funds assumes that factor scores accurately reflect the relative need among recipients for VEA funds. As we concluded in Chapter 3, relative financial ability and concentration of low-income persons or higher cost students are accepted factors probative of an LEA or OER's relative need for VEA funds. As general need indicators, it is our conclusion that they are superior to most others. However, given the variety of permissible uses and legitimate state policies in vocational education, we can envision situations in which absolute adherence to this parameter would not maximize the goal of assuring that additional VEA funds are allocated to those recipients most in need of them. Consequently, as described below, we also recommend that states be permitted to override the general funds distribution parameter we have recommended.

The function of the general fund distribution parameter described above is to determine a general need for vocational education funds, based upon number of students, relative financial ability, and concentrations of low-income persons and higher cost students. It does not necessarily determine the need for a specific vocational education service, program or program component. For example, it does not necessarily indicate the precise relative need of recipients for a new program in computer programming or diesel mechanics; or the relative need to replace obsolete equipment; or the need to equip new facilities; or the need to expand apprenticeship, cooperative education or guidance and counseling programs.

Unfortunately, we did not see as much evidence as we had hoped to find that states had sought to identify such relative needs of recipients with any precision. For example, no state we reviewed had conducted an inventory of vocational education programs, equipment or facilities provided by eligible recipients or had an inventory of recipient deficiencies and needs. Some states indicated they reviewed applications for new programs closely to prevent program duplication. Several also indicated they were attempting to expand regional vocational structures as a way of expanding program opportunities in sparsely settled areas of their states. Except for the expansion of regional structures, the state role appeared essentially reactive to the initiative of applicants. While recipients may be good judges of their own needs for vocational education, it did not appear that states generally attempted to identify and put priorities on the relative needs of competing applicants. At least this did not appear to be a major concern in the funding distribution process.

It is our conclusion, however, that, in cases in which states identify needs for vocational education with greater precision, the VEA funding formula should accommodate the state's interest in addressing such needs.

Consequently, we recommend that states be permitted to override the allocation amount determined by the general formula on the basis of (1) *objective criteria of specific need for vocational education* that indicate that an eligible recipient has a greater need for the vocational education program or service being funded than would appear from the funding formula calculation, and (2) *the agreement of recipients to use VEA funds to meet those needs*. We recommend that the term "objective criteria of specific need for vocational education" be defined as a quantifiable standard of need for particular programs, services, facilities or equipment for which VEA funds are designated by the state. The deviation of a recipient from this standard would be the basis for funding the recipient to meet the standard. Objective criteria of specific need for vocational education could include the absence of certain vocational education programs the state seeks to expand; or the lack of certain program methods for which VEA funds are specifically provided, *e.g.*, work-study, cooperative or apprenticeship programs. These criteria could also include, for example, the value of obsolete equipment needing replacement or the number of students waiting to be admitted to specific vocational education programs.

Under the formula entitlement method, the funding formula would determine a preliminary amount for each applicant. To apply the objective need criteria, the funding formula would also be used to rank applicants from highest to lowest need. The objective need criteria could then be used to determine whether higher ranked applicants should have their preliminary amounts decreased or increased or should be skipped entirely.

Essentially, the objective need criteria would be used to set a service or program standard against which the need for VEA funds would be judged. Such criteria appear most appropriate for use in funding pools that the state establishes to promote particular vocational education purposes. For example, a funding pool might be set up to pay for the replacement of obsolete equipment in certain business education programs. The general formula would calculate the preliminary amount each eligible recipient is entitled to receive. The formula would also be used to rank eligible recipients in order of need. The objective need criteria could be the age of a recipient's business education equipment needing replacement. In simplified form this ranking might be as follows:

	Total Formula Points	Amount of Preliminary Entitlement	Value of Business Equipment that is Older than State Age Criteria	Amount of VEA Funds Received
LEA 1	100	$10,000	$ 8,000	$ 8,000
LEA 2	70	7,000	12,000	12,000
LEA 3	40	4,000	2,000	2,000
LEA 4	20	2,000	3,000	1,000
	230	$23,000	$25,000	$23,000

Here the state has used the criteria of specific need for replacement of equipment which is beyond a certain age to override the preliminary entitlement calculated by the formula. Some receive more andsome receive less, based on their specific need. And the state could put other parameters on this process; for example, it could specify that no recipient could receive more than 120% of its entitlement, which would have limited LEA 2 to $8,400 rather than $12,000.

Most of the flexibility we are recommending is already present in the existing legal framework, but it is not clear to all of the states we reviewed. In addition, under the present structure the ability of a state to take into account the particular needs of recipients for VEA funds may depend on whether the state is now using a direct allocation formula, a percentage reimbursement formula, or the project method of funding. Essentially, our recommendation would permit states to combine many of the features of each of these methods, and to eliminate the present situation in which the method a state chooses to use determines to some extent its flexibility under the VEA. These issues are more fully developed in section IV of this chapter, which considers the way in which funds distribution requirements operate in allocating funds for various uses permitted under the VEA; and more fully develops concepts such as funding pools and the project method of funding.

5. The Information States Report on Formulas

We found in our own review of the state and annual program plans and accountability reports that the information submitted to ED was not adequate either to understand the elements of the distribution formula, how it works in theory and in practice, or the outcome of the formula. For instance, seldom did states report their use of separate funding pools or the precise scaling and interrelationship of the distribution factors. In almost every case an important element necessary for understanding the formula was omitted. Typically, the only information concerning the amounts of VEA funds allocated to each recipient was the total amount received.

Total dollar allocations are useless for making comparisons since they ignore differences in enrollments, numbers of teachers, value of equipment, and all other elements that reflect differences in the size or program size of recipients. ED recognized this fact in early drafts of its manuals on fund distribution which stated that states must provide examples that demonstrate that the fund distribution procedures "provide the largest allocation of funds on a per student basis to eligible recipients with the greatest need."[113] ED, however, never followed up on this, and most amounts reported by states as allocated to recipients were useless totals rather than per student amounts.

In most cases it was impossible to tell from state reports how the specific factors in formulas operated and interacted to achieve the actual distribution among recipients for a particular year. For example, the points or other factor scores for each formula factor for recipients were not generally reported, and information on the characteristics of recipients such as enrollments, assessed valuation per pupil or percentage of low-income persons, which would have permitted close analysis of the formulas from the state reports, was typically absent. This is not required to be included by ED even though all this information is readily available, since it is the basic data which operates the formulas.

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[113] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979.

Consequently, we recommend that the legal framework be clarified to require states in five-year plans to include a complete description of the formula, including complete definition of all factors used (including data sources), the factor scales, all mathematical computations, together with examples of how the formula will operate based on data from actual LEAs and OERs.

We also recommend that annual program plans and accountability reports include, in addition to descriptions of any changes in the formula, the amounts per pupil allocated to each recipient under each separate formula, or on another basis that takes into account differing recipient and/or recipient program size.

We further recommend that in the first year following the use of a formula or any formula changes, the state additionally report the raw data values and factor scores for each recipient funded, with such data reported for each formula(by recipient)in rank order of the amount per pupil received by recipients. Such information will permit intelligent review of the results of VEA formulas.

All such information is readily available since these data are used to operate the formula.

IV. Applying the General Formula Requirements to the Various Uses of VEA Funds

A. Introduction

1. Purpose and Organization

Section II of this chapter considered the formula requirement of the VEA. Section III analyzed the general VEA requirements relating to the design of the state formulas for distributing VEA funds among recipients. The major focus of this section of chapter 4 is on the legal framework for applying the general fund distribution requirements discussed in chapters 2-4 to the variety of uses required or permitted under the Act. We discuss in detail one method of allocating VEA funds to recipients for particular uses, the project method, and two mechanisms used to allocate VEA funds to recipients for particular purposes, funding pools and set-asides.

This section is divided into four subsections. This first subsection, gives an overview of the organization, the legal framework and the major findings and conclusions. Subsection B describes the legal framework concerning: (1) the required and permitted uses of VEA funds; and (2) the requirements and options for applying the general fund distribution requirements of the VEA to particular uses. Subsection C describes the state legal framework for funding particular VEA uses including how states use funding pools, set-asides and the project method of funding. Subsection D contains our policy analysis and findings, conclusions and recommendations concerning the clarity, consistency and adequacy of the VEA legal framework for the allocation of VEA funds for particular VEA uses.

2. Overview of the Legal Framework

a. Required and Permitted Uses -- The VEA has two kinds of uses: required and permitted. Required uses, in turn, are of two types. One type of required use results from Congress establishing a separate authorization or appropriation for a particular purpose, e.g., Subpart 4 (Special Programs for the Disadvantaged), Subpart 5 (Consumer and Homemaking Education). The other type of required use results from Congress' specifying that a certain percentage of a state's allotment must be used for a particular purpose, e.g., of subpart 2 and 3 funds, the state must use 10% for handicapped and 20% for disadvantaged persons. These percentage requirements are commonly called "set-asides."

There are also two types of permissive uses that are of relevance to funds distribution issues. In allocating funds for the first type, states must use priorities in addition to these specified for other VEA funds. For example, the section 121 work-study and the section 122 cooperative vocational education programs require a preference or priority to be given for the factors of school dropouts and youth unemployment.[114]

These are considered permissive uses because the VEA does not require states to use their VEA funds for these purposes. The second type of permissive use is distinguishable from the first by not being subject to any fund distribution priorities or factors in addition to the general requirements of Section 106(a)(5). Most of the uses of Subpart 2 Basic Grant Funds, other than work-study and cooperative education programs, are in this category.

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[114] These additional priorities are discussed in greater detail in Chapter 2, supra at 60.

b. Methods of distributing VEA funds -- The project method, which is typically used to allocate VEA funds to particular uses, was briefly mentioned in Chapter 3 as one of the three possible methods of distributing funds. Chapter 3 focused on the other two methods of distributing funds: the direct allocation method and the percentage reimbursement method. The direct allocation method calculates a specific amount of VEA funds an applicant is eligible to receive. In contrast, the percentage reimbursement method determines a variable percentage of specified vocational education costs which Federal funds (or the local match) will pay for. In this section we will describe how these methods have been and can be adapted to the allocation of funds for various uses, within the VEA legal framework. The discussion of funding methods will also focus on a third method of allocating VEA funds, the project method.

Under the project method, recipients propose their own funding levels and the VEA fund distribution factors are used to rank applicants for funding. Typically, applicants are funded in the order of their rank, and the amount of VEA funds they receive is the amount necessary to fully fund their approved applications. Often a variable local match is deducted. This local match is calculated based on the same formula used to rank applicants. Applicants below the point on the rank at which available funds run out receive no funds. Most states we reviewed used the project method to allocate funds for some purposes.

c. Mechanisms for allocating funds to uses -- The discussion of the project method in this section is preceded by an analysis of two specific mechanisms for allocating VEA funds to particular VEA purposes: the funding pool and the set-aside.

A funding pool is a separate portion of the total fund of money for which applicants separately apply. An applicant for funds from a funding pool is approved on the basis that the applicant agrees to use funds for a specified purpose, *e.g.*, new programs,[115] replacement of obsolete equipment, programs for handicapped students, guidance and counseling programs. Most states we reviewed use funding pools for some purposes. They are a mechanism which states use to encourage recipients to use VEA funds for particular purposes.

Set-asides serve a similar purpose. A set-aside is a specified portion of a total amount of funds that an applicant must agree to use for a certain purpose or in a certain manner. Unlike the funding pool, the set-aside is mandatory rather than optional: to receive *any* of the total amount of funds the applicant wants, it has to agree to spend a portion (usually a percentage) in a particular way. In contrast, where a funding pool is used an applicant may choose to not apply for a particular funding pool and may still apply for other VEA funds. States sometimes use set-asides to pass through to recipients the set-aside requirements of the VEA to which the state is subject, e.g., with respect to funds for handicapped and disadvantaged students.

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[115] Funding pool issues were introduced in chapter 2 in the discussion of the application approval priority for new programs. See Chapter 2 at p. 33-47.

Funding pools and set-asides are not funding formulas. Rather, they are mechanisms states have used to adapt the general fund distribution requirements to the funding of particular purposes. In other words, these are mechanisms that determine the use to which VEA funds will be put, prior to the calculation of the amount of funds a particular applicant will receive. Furthermore, any of the fund distribution methods can be used with these mechanisms; however, the set-aside mechanism is not usually used with the project method. But all three funding methods are used with funding pools.

3. Major Findings, Conclusions and Recommendations

a. Funding pool and set-aside mechanisms -- We found funding pools and set-asides to be important mechanisms for carrying out Federal and state policies concerning uses to which VEA funds should be put. Both mechanisms enable states (1) to ensure that recipients are using funds in accordance with the Federal priorities in the legislation and (2) to further state policies that VEA funds should be used for particular purposes. These mechanisms require recipients to agree to use VEA money and any required matching funds for those purposes, or to forego them.

Despite the importance of these mechanisms for carrying out the multiple objectives for vocational education of the VEA and the states, ED has not provided clear and consistent guidance concerning their use in meeting various program priorities. We found the legal framework to be unclear with respect to the use of these mechanisms for new programs, programs for the disadvantaged, or how the application approval priorities can be met through the use of funding pools and set-asides.

We conclude that both of these mechanisms are useful and important tools to advance Federal and state priorities in vocational education. We recommend that their use in the VEA legal structure be clarified. Of particular importance is the need to clarify that application approval priorities such as new programs can be met only by establishing funding pools or set-asides for these priorities.

b. The project method of funding -- The project method of funding is commonly used where the amount of funds needed by recipients for a particular purpose is not roughly proportional to the number of students enrolled (or other recipient size measure) or where a direct allocation of funds may be spread too thinly to ensure programs or services of sufficient size, scope and quality.

The project method is typically used in connection with funding pools for particular purposes. In concept, the project method of funding is inconsistent with a set-aside since the project method assumes a budget proposed by recipients while under a set-aside the state establishes a fixed percentage of a total amount that must be used for a particular purpose.

Although the majority of states we reviewed use the project method for funding some VEA purposes, the legal formula does not clarify how the fund distribution provisions apply to projects. It is clear that they apply from both the legislative history and ED interpretation. We identified two problems which require further clarification. First, it is not clear how states are to apply the distribution factors in a meaningful fashion if all applicants are to be funded under the project. Second, ED has not required that there be a significant variation in the funding level for approved project applicants.

With respect to the first problem, we recommend that states be required to report the ranking used for project funding and demonstrate that some cut-off is used. The second problem would be remedied by our recommendation in section 3 of this chapter that a ratio parameter be placed on percentage reimbursements. As described in that section, the ratio parameter would require that the variation in VEA percentage reimbursements among recipients not be less than the ratio of the differences in recipients' total factors.

B. Federal Legal Framework

1. Overview of Required and Permitted Uses of VEA Funds

The VEA, since its amendment in 1976, is organized into five subparts (Subpart 1: Administration; Subpart 2: Basic Grant; Subpart 3: Program Improvement and Supportive Services; Subpart 4: Special Programs for the Disadvantaged; and Subpart 5: Consumer and Homemaking Education). Subparts 2-5 each describe the permitted and required uses for funds appropriated for that subpart, i.e., subpart 2, the Basic Grant specifies thirteen purposes for use of these funds from among which states may select.[116/] In addition, one of these authorized purposes, "vocational education programs," is so broad that the basic grant can be used to fund almost any activity justifiably related to "vocational education" except the acquisition, construction or initial equipping of certain facilities.[117/] States are also authorized to use subpart 3 funds for a variety of program improvement and supportive services.[118/]

The subpart 4 appropriation is to be used in its entirety for special programs for the disadvantaged. Subpart 5 funds must be used for consumer and homemaking education.

[116/] Section 120(b) of the VEA (20 U.S.C. 2331(b)).

[117/] See the definition of "vocational education" in Section 195(1) of the VEA (20 U.S.C. 2461(1)). Basic grant funds can be used for the construction of area vocational and residential vocational schools. Section 120(b)(1)(E) and (M).

[118/] Section 130 of the VEA (20 U.S.C. 2350).

The VEA requires that certain percentages of the total amount of subpart 2 and 3 funds be used for particular purposes. First, the VEA specifies the percentage of this total that must be used for subpart 2 (80%) and for subpart 3 (20%).[119] Of the combined appropriation for subparts 2 and 3, states must also set-aside minimum percentages for national priority purposes:

(1) at least 10% for handicapped persons;

(2) at least 20% for disadvantaged persons; and

(3) at least 15% for post-secondary and adult education.[120]

Additional percentage requirements apply to subpart 3 program improvement and supportive services funds. States must use at least 20% of these funds for guidance and counseling programs;[121] and states are prohibited from using more than 20% of subpart 3 funds for supervision and administration.[122]

The above percentage requirements all specify how states are to use a portion of VEA funds. An additional percentage requirement applicable to subpart 5, consumer and homemaking education programs, specifies where a portion of subpart 5 funds must be used: at least one-third must be used in economically depressed areas.[123]

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[119] Sec. 103(e) of the VEA (20 U.S.C. 2303(e)).

[120] Sec. 110(a)(b) and (c) of the VEA (20 U.S.C. 2310 (a)(b) and (c)

[121] Sec. 134(a) of the VEA (20 U.S.C. 2354(a)).

[122] Sec. 130(b)(7) of the VEA (20 U.S.C. 2350(b)(7)).

[123] Sec. 150(c) of the VEA (20 U.S.C. 2390(c)).

2. Requirements and Options for Applying the General Fund Distribution Requirements of the VEA to Particular Uses

a. General requirements -- As discussed in section II of this chapter, ED has interpreted the fund distribution requirements of section 106(a)(5) and the formula requirement to apply to all funds allocated to LEAs and OERs under subpart 2 (basic grant), section 134 of subpart 3 (guidance and counseling), subpart 4 (special programs for the disadvantaged) and subpart 5 (consumer and homemaking education).

The statute, however, is silent on the range of options states have for applying the general fund distribution requirements of the VEA to the particular uses.

The House, which proposed the fund distribution requirements of section 106 (a)(5)(B)(i), noted in its report that it did not intend to preclude states using either an "entitlement basis" or a "project grant application basis" for distributing funds since there are "advantages and disadvantages to both."[124] The report stressed however "that whichever system is used in determining the recipients of these funds the financial ability and the number of low-income, or high cost students within them must be the most important factors in their choice."[125]

ED's most recent interpretation, which paraphrases this legislative history, authorizes both the "planning entitlement method" or the "project grant application method." And both methods must comply with the requirements concerning application approval priorities and fund distribution factors.[126]

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[124] H.R. Rep. No. 94-1085 at 34.

[125] Id.

b. Taking into account variations among applicants in need for a particular program or service -- ED has not directly dealt with what a state's options are for taking into account variations among applicants in the need for a particular program or service. However, one of ED's draft fund distribution manuals included a "model" formula which used different enrollment multipliers for different programs.[127] For example, a recipient's entitlement per pupil was multiplied by number of total vocational pupils enrolled to calculate its basic entitlement; its per pupil entitlement under the program for handicapped students was multiplied by its number of handicapped students.

A later interpretation generally authorized the use of vocational program size in conjunction with the required fund distribution factors, but did not provide examples of how this would be done for different VEA program purposes.[128]

c. The use of funding pools -- ED has consistently authorized states to use funding pools for some purposes and required that "when funds are to be provided from these funding pools to eligible recipients they must be distributed through the required fund distribution procedures."[129]

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[126] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

[127] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedure, Sept. 1979 at 14.

[128] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

[129] See e.g., Id.

However, ED's description of the type of funding pools that a state could set up has changed over time.

An early draft manual on funds distribution appeared to limit the use of funding pools to dividing "Subparts 2, 3 and 5 funds by program purposes" such as work-study programs, energy education and industrial arts programs.[130] Subsequently, this general statement was expanded to include "program purposes, level of program and/or types of institutions."[131]

ED's written interpretations concerning authorization to use pools for handicapped and disadvantaged programs have also changed over time. ED's draft manuals originally dealt with the funding of these programs under the separate heading of "Set-Asides and Required Expenditures," stating that "[r]equired set-aside funding amounts for handicapped, disadvantaged, and post-secondary programs must also flow through the established fund distribution process(es)."[132] In several subsequent drafts, this language was moved to the "funding pool" heading with an additional reference to using pools for "national priority programs."[133] However, in ED's final interpretation relating to funding pools there was no reference to handicapped, disadvantaged or national priority programs, although pools for post-secondary institutions were specifically authorized.[134]

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[130] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3.

[131] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

[132] BOAE/DSVPO Draft Manual for Federal Fund Distribution Procedures, Sept. 1979 at 3.

[133] BOAE/DSVPO Draft Manual for Federal Vocational Education Fund Distribution Procedures, Nov. 1979 at 4; and Dec. 1979 at 5.

[134] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

ED's early draft manuals also did not specifically authorize the use of funding pools for new programs.[135] ED's final interpretation now clearly authorizes funding pools for new programs, but does not spell out whether the application approval priorities of new program and EDA can be omitted from the distribution formula.[136]

On at least one occasion, Federal administrators encouraged a state to adopt funding pools for portions of the VEA allocations which require different or additional funding criteria, in this case for cooperative vocational education and work-study programs.[137]

ED has required that distributions from funding pools use the required fund distribution procedures.[138] However, prior to 1981, ED's draft manuals on funds distribution implied that a "two-step prioritizing/funding process" was to be used with funding pools. Under this method, EDA and new program criteria would be used to "prioritize applications" and RFA and low-income would be used to "rate applications;" and these scores would be converted into an allocation to recipients.[139]

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[135] The first reference to the use of funding pools for new programs appeared in the December 1979 Draft Manual for Federal Vocational Education Fund Distribution at 5, which authorized pools for "new programs to support new industries."

[136] ED's final interpretation states that funds provided to eligible recipients from funding pools "must be distributed through the required fund distribution procedures." OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981). As developed in chapter 2, ED has not clearly announced whether a factor for new programs must be included in a formula that distributes funds from a new program funding pool. Our recommendation to prohibit new programs and EDA from being used as formula factors would eliminate this problem. See chapter 2 at pp. 47-59 and Section III of this chapter at p. 71.

[137] State Plan Quality Review, California Annual Program Plan Fiscal Year 1979 at 5 (Feb. 14, 1979).

[138] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

d. The use of set-asides -- We found no written interpretations concerning the use of set-asides in state allocation procedures. However, our interviews indicated that ED had permitted states to require that each recipient set aside certain percentages of its VEA allotment for specified purposes.[140]

e. The use of the project method of funding -- As described above under "General Requirements", the legislative history indicated that Congress, by adopting the fund distribution factor requirements in the 1976 amendments, did not intend to prohibit the "project grant application basis" for distributing VEA funds, but did intend that RFA and low-income/higher cost student factors be the most important factors "in determining the recipients of these funds."[141] ED's interpretation paraphrases the legislative history.[142]

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[139] See, e.g., BOAE/DSVPO Draft Manual for Federal Vocational Education State Grant Distribution Procedures, July 1980 at 7-8.

[140] The Funds Distribution Manuals refer to "set-asides" but, in context, these are referring to the state obligation to set aside a portion of its allocation for certain purposes. See, e.g., BOAE/DSVPO Federal Fund Distribution Procedures, Sept. 1979 at 3.

[141] H.R. Rep. No. 94-1085 at 34.

[142] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981). An earlier draft interpretation stated "Funds used to support projects through a competitive process must also be distributed using the fund distribution factors (except RCU contracts)." BOAE/DSVP Draft Information Manual for Federal Vocational Education State Grant Fund Distribution Procedures, July 1980 at 5.

C. State Legal Framework

1. Introduction

Funding pools and/or set-asides were used by all four of our study states to distribute specific portions of VEA funds for particular purposes, and three out of the four used both mechanisms.

Three of the states also used the project method of funding for some purposes. In some cases the project method was combined with a variable percentage local match.

Much of the information on funding pools, set-asides and projects had to come from state interviews, since state plans and reports did not adequately describe these mechanisms.

2. Use of Funding Pools

All states used separate funding pools for different types of institutions, e.g., LEAs serving post-secondary school populations, community colleges. Beyond this basic dichotomy, three of the four states made use of the funding pool mechanism to govern the use to which recipients put VEA funds.

New programs were funded through funding pools in two states.[143] One state distributed this pool on a competitive project basis. In this state the new program pool is utilized for new equipment. Applicants interested in new programs submit separate proposals and are ranked using the funding criteria. In the other state, applicants applying for pool funds receive an entitlement calculated by formula. In three states funding pools were also used to allocate funds for a number of other purposes. We found that pools were established for national priority programs for handicapped and disadvantaged students, subpart 4 disadvantaged programs, subpart 3 guidance and counseling programs, and subpart 5 consumer and homemaking programs (including the 33% expenditure in economically depressed areas).[144]

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[143] In both instances, ED approved these new program funding pools. ED has vacillated, however, on the question of whether these pools satisfied the VEA requirement that states give priority to applicants proposing new programs. This issue of the "priority" for new programs is discussed in section IV of chapter 2 at p. 47.

3. Use of Set-Asides

Only one state in our research sample did not use the set-aside mechanism as a way of requiring recipients to use a portion of their overall allocation for a particular purpose.[145]

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[144] One state created pools from which applicants could apply for mandatory set-asides for handicapped/disadvantaged and post-secondary adult programs, as well as pools for the subpart 4 (disadvantaged) and subpart 5 (consumer and homemaking education). The second state created pools for subpart 4 funds and the mandatory set-aside for limited-English-speakers. The third state uses funding pools at the secondary level for its subpart 4 disadvantaged programs and section 134 guidance and counseling programs.

[145] This state assured that overall percentage requirements, e.g., for handicapped and disadvantaged programs, would be met by using funding pools for them.

All three of the remaining states distributed at least a portion of their VEA allotment on the condition that recipients use designated amounts of those funds for particular uses.

One state uses the set-aside mechanism to ensure that all of the VEA's particular use requirements are met statewide. Each recipient, as a condition to receiving Federal funds, is required to spend 10% for the handicapped students, and 20% for disadvantaged students. Subparts 4 and 5 funds are also distributed as set-aside amounts.

Including this state, a total of three of the four states allocate funds for handicapped and disadvantaged programs in the form of mandatory set-asides under the regular VEA grant. Each recipient must use a specified portion of its total allocation for these programs. These three states also allocate subpart 5 consumer and homemaking education funds as a set-aside portion of each recipient's allocation.

Several of these states use different formulas for allocating certain set-aside funds than for other allocations. Generally, the set-aside formulas differ only in that they take into account the number of students enrolled in the program for which the set-aside is to be used, e.g., handicapped students, or students enrolled in consumer and homemaking programs. Thus, the use of separate formulas did not necessarily indicate that the state was using a funding pool for that purpose. Rather, the amount calculated under a separate set-aside formula was simply added to other amounts allocated to a recipient to determine its total allocation. But to receive the total allocation, applicants had to agree to use required portions of the funds for set-aside purposes.

Some states, which tied their handicapped and disadvantaged programs as a set-aside to regular grant funds, reported that some recipients had trouble spending their full allocations in the years immediately following the 1976 amendments, and that recipients were carrying-over significant portions of these set-asides. We were informed, however, that these difficulties have, to a great extent, abated as time has passed.

4. Use of the Project Method of Funding

Three of the four states use the project method to distribute at least some VEA funds. In each of these states the funding concept of the project method was that each applicant would apply for the amount of funds it considers necessary for a particular purpose, and the objective of the state was to see that the total approved project, often including a variable local match, was funded. Project funding was determined by the order in which applicants were ranked, based on need.

Of the three states which use the project method, one uses the project approach to allocate all funds for disadvantaged and handicapped programs under subparts 2 or 3 and the special disadvantaged programs of subpart 4.

Another state uses the regular formula to calculate a direct allocation for handicapped and disadvantaged programs, and only uses the project method to fund LEAs whose "entitlement" for these programs fall below a specified dollar amount. This state also uses projects for subpart 4 funds, and beginning in 1981-82, for limited-English-speaking programs.

The third state made extensive use of the project method. All funds for post-secondary institutions were allocated by this method. In addition, LEA funds for subpart 4 special programs for the disadvantaged, adult programs, construction, limited-English-speaking programs, and industrial arts and guidance are allocated by projects.

States employ different processes to identify project recipients. Two states first use a cut-off point based on VEA formula factors to determine which LEAs or OERs may submit a project proposal. A request for proposals is sent to the identified eligible recipients, and interested agencies and institutions submit funding proposals in response. In the third state all agencies and institutions which are considered eligible recipients may submit proposals.

In general the amount of funding is determined by the project application which is approved by the state. Thus, the amount of funds one applicant requests can affect the amount remaining to fund other applicants. We were informed in interviews in several states that negotiations are sometimes conducted to establish the amount of funds each recipient may request or the state will approve. In one state, this is done jointly with a number of recipients.

Applicants are ranked to determine the order in which they will be funded. All three states use the scores from the VEA funding formula to rank proposals. Two of the three states allocate sufficient funds to their project pools to fund each applicant fully at the level of its approved request. The third state funds each approved applicant at the level of its request in the order established by the ranking and has run out of funds each year before completing the list.

Two of the three states use the same formula to calculate a variable local match for some project purposes.[146] The third state requires a 50/50 match for all projects except those for subpart 4 funds. The variation in the local match, which is the percentage of the total project amount which recipients are expected to fund from non-VEA sources, tends to be small. For example, one state divides applicants into three groups (based on formula factors) and the match varies from 0 to 10% in one project to from 60% to 70% in another. In a second state the new program project match varies from 40% to 60%.

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[146] One of these states has a variable local match for all projects. The other state, which also funds all applicants, has no variations in its project match except for its new program funding pool.

D. Findings, Conclusions and Recommendations

1. Funding Pool and Set-Aside Mechanism

We found funding pools and set-asides to be important mechanisms for carrying out Federal and state policies concerning uses to which VEA funds should be put. Both mechanisms enable states (1) to ensure that recipients are using funds in accordance with the Federal priorities in the legislation and (2) to further state policies that VEA funds should be used for particular purposes. These mechanisms require recipients to agree to use VEA money and any required matching funds for those purposes, or to forego them.

Funding pools and set-asides also enable states to account for required expenditure levels (*e.g.*, the national priority programs minimum percentage expenditures).

Segregation of VEA funds into funding pools and set-asides also gives states a mechanism for applying different formulas to allocate VEA funds for different purposes. In some cases states have used separate formulas in an attempt to meet the additional priority requirements for the distribution of funds for cooperative education, work-study and a portion of subpart 5 consumer and homemaking programs.[147] In other cases states have used different distribution formulas for pool funds because they considered them more appropriate than the formulas for general purpose distributions, *e.g.*, some states use a total enrollment multiplier in their general formulas and a handicapped enrollment multiplier for distribution of funds for handicapped programs.

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[147] These additional priorities are discussed in Chapter 2 at pp. 60-69.

The creation of funding pools and set-asides by states is one of the most tangible impacts of the state planning process in funding. Under the 1976 amendments states were given additional discretion about the use of VEA funds. We found that states had exercised this discretion differently, and this was most clearly reflected in decisions about the creation of funding pools and set-asides for particular purposes, or the decision to create a funding pool rather than a set-aside for a particular purpose.

Funding pools and set-asides have somewhat different policy consequences. In general, the set-aside is a more direct mechanism for ensuring that VEA funds are used for a particular purpose than is the funding pool. The funding pool, for example, does not ensure that all recipients of VEA funds in a state use some VEA funds for a particular purpose, e.g., for programs for disadvantaged students. Only those applicants that apply for the funds in the pool agree to comply with the conditions on the use of pool funds. And, most importantly, the failure to apply for funds from a particular funding pool does not prevent an LEA or OER from applying for other VEA funds. Set-asides, on the other hand, make it a condition of the receipt of any VEA funds that the applicant use a portion of these funds for a particular purpose. Unlike the funding pool, the set-aside requires the applicant to accept the funds with the condition or to forego all funds.

We found that several states used set-asides to ensure that every recipient carried an equal share of meeting Federal priorities such as providing vocational programs for handicapped and disadvantaged students.

One state official thought that it would be difficult to get enough districts to voluntarily seek these funds, and that the set-aside requirement facilitated the state's satisfaction of its obligation. State officials also indicated that the set-aside mechanism permitted the state to require these important program activities in each jurisdiction, using the Federal government as a convenient scapegoat. This assists unpopular but important priorities to be implemented statewide.

The funding pool mechanism has certain advantages as well. It can, for example, be used to direct funds to fewer applicants and often in greater amounts. It thus can be made more responsive to the concept that programs should be of sufficient size, scope and quality to be of educational benefit. The fact that application for funding from a pool is voluntary may help to ensure a greater degree of interest in carrying out the objectives of the funding pool.

Despite the importance of these mechanisms for carrying out the multiple objectives for vocational education of the VEA and the states, ED has not provided clear and consistent guidance concerning their use in meeting various program priorities. We found the legal framework to be unclear with respect to the use of these mechanisms for particular purposes (e.g., for new programs, and disadvantaged programs) and how the application approval and fund distribution requirements relate to set-asides and pools.

ED's interpretation of the interaction of the application approval factors (new programs and economically depressed areas) with funding pools and set-asides created perhaps the greatest confusion. This has already been briefly discussed in chapter 2.[148/] ED's original draft interpretation on funding pools did not mention new programs. The draft interpretations did, however, assume that new programs and EDA would be converted into mathematical factors in both the "two-step" and "one-step" processes. Later interpretations referred to new program funding pools, but continued the same interpretation concerning the need to make new programs into a mathematical factor. We found that this created substantial confusion among the states, and as discussed in chapter 2, we have concluded that the new program priority can only be carried out by the creation of funding pools or set-asides for new programs. ED appears to have permitted several states to use funding pools for new programs to satisfy this priority in lieu of using a mathematical factor for new programs, but ED's written interpretations do not reflect this. In chapter 2, we recommended that this be clarified.[149/]

[148/] See Chapter 2 at pages 47-68 for citations to ED interpretation and a more detailed analysis.

[149/] If application approval priorities are to be satisfied, as we recommend, by creation of funding pools or set-asides for these priorities, the VEA should also specify the amount of VEA funds a state must use for these purposes to satisfy the "priorities." This failure of the VEA to specify how much priority should be given, as well as the mechanisms for giving priority, contributed to ED's inappropriate interpretations concerning the application approval priorities.

Another issue on which the legal framework is unclear is how states are to apply the fund distribution factors to funding pools and set-asides. In its latest interpretation, ED outlined several general options for taking the size of a recipient or its vocational education program into account in funding,[150] but ED has never explained the options for doing this by using funding pools and set-asides for various program purposes.[151] Some states developed appropriate ways of adapting the formula requirement to particular set-asides and pools, e.g., by using handicapped and disadvantaged students as formula multipliers in pools and set-asides for these purposes. However, clarification and specific authorization of appropriate ways to use formula factors for specific purposes probably would have avoided much of the confusion about fund distribution requirements that followed the 1976 amendments.

We conclude that both of these mechanisms are useful and important tools to advance Federal and state priorities in vocational education. We recommend that their use in the VEA legal structure be clarified. Of particular importance is the need to clarify that application approval priorities such as new programs can only be met by establishing funding pools or set-asides for these priorities.

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[150] OVAE/DSVP Program Memorandum FY 81-5 at 3 (Feb. 11, 1981).

[151] ED has given even less attention to the use of set-asides than to funding pools. Set-asides imposed by states on recipients are not even discussed in VEA manuals, and there is no mention of the purposes for which states may create set-asides. States, however, appear to have had fewer difficulties with this mechanism because they generally link the general formula entitlement with the set-aside, specifying that recipients must use portions of it for particular purposes.

Most problems relating to the use of fund distribution factors in allocating funding pool or set-aside funds among recipients have resulted from the general confusion concerning fund distribution procedures described in chapters 2 and 3 and in section III of chapter 4. The recommendations made there would, in our opinion,result in fund distribution procedures that are applicable for general purpose VEA distributions and specific set-asides and funding pools. The major additional clarification needed is that the recipient or program size factor used in the formula for each funding pool or set-aside should be appropriate to the particular program being funded. As is described in section III and further considered in the next subsection on project method funding, the VEA and our recommended clarifications afford states great flexibility in VEA funds distribution, consistent with VEA objectives and state priorities.

2. The Project Method of Funding

The project method of funding is commonly used where the amount of funds needed by recipients for a particular purpose is not roughly proportional to the number of students enrolled (or other recipient size measure) or where a direct allocation of funds may spread funds too thinly to ensure programs or services of sufficient size, scope and quality. Thus, projects have been used to allocate funds for acquisition of new or replacement of obsolete equipment, start up costs for new programs and construction, all of which are costs that may not be proportional to recipient size. They have also been used to provide additional funds to applicants who, for example under an entitlement formula for handicapped or disadvantaged funds, would receive only tiny amounts of funds.

Projects were uniformly used in connection with funding pools for particular purposes. In concept, the project method of funding is inconsistent with a set-aside since the project method assumes a budget proposed by a recipient, while under a set-aside the state establishes a fixed percentage of a total amount that must be used for a particular purpose.

Contrary to what might be expected, projects do not necessarily allow greater state control over the use of funds nor do they necessarily result in greater state oversight. First, projects, although often confined to a particular state purpose, must be locally initiated. Second, as one state official stated, there may be too many project proposals approved for too many different activities to permit the state to monitor what recipients are doing with the funds. This official was of the opinion that the state had more direct policy impact when allocating funds as direct allocations based on approved applications, rather than as projects. There did not appear to be any unanimity among states on this, however.

Although the majority of states we reviewed use the project method for funding some VEA purposes, the legal framework does not clarify how the fund distribution provisions apply to projects. It is clear that they apply from both the legislative history and ED interpretation.

ED, however, appears to have informally communicated several interpretations relating to projects to the states. First, formula factors must be used to rank applicants for project funding, and applicants must be funded in the order of this rank. Second, some states understood that formula factors must also be used to calculate a variable local match/VEA percentage on the amount of the total project budget of each recipient. These interpretations are illustrated by the following example.

In this example there are three LEAs. Based on formula factor totals, LEA 1 is high need, LEA 2 is average need and LEA 3 is low need.[152] The amount of this project funding pool is $85,000.

	Factor Total	Project Amount Sought	VEA Percentage	Amount of VEA Funds Sought
LEA 1	20	$50,000	80%	$40,000
LEA 2	15	$75,000	60%	$45,000
LEA 3	10	$50,000	40%	$20,000
		$175,000		$105,000

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[152] In calculating these formula totals we found that states generally did not include recipient size multipliers since size was accounted for theoretically in the amount of funds each applicant applied for.

Under the project method the total budget for the project is approved by the state and that amount of VEA funds, less the local match, is allocated to the applicant.

Thus, the state, after applying the match, has funds sufficient to fund only LEAs 1 and 2. LEA 3 would receive no funds.

We found ED's informal interpretation requiring recipient ranking and variable percentage reimbursement for the project method to be consistent with the fund distribution objectives of the VEA. ED, however, has not addressed two problems which have arisen under this interpretation. First, several states have used the project method to fund all applicants, making the initial ranking to determine the order of project funding a meaningless formality. Second, the range of variation of the percentage reimbursement is so small in some cases as to be inconsequential. In our opinion, both problems can be dealt with by the clarifying interpretations which we recommend below.

We first deal with the problem of rendering the initial ranking meaningless by funding all applicants. It is important to recognize that this may encompass two very different fact situations. In one where applications for project funds are unrestricted this is a real problem; in the other, where the state limits eligibility to only high need applicants, it may in fact not be a problem.

In the first situation the state permits any eligible recipient (e.g., any LEA) to apply for funds from a particular project pool. Here any applicant, be it a low need or high need agency or institution as measured by formula factors,can apply for an amount for a particular purpose, e.g., equipment replacement. And the state, which set-up the project pool, can put sufficient funds in it to fund the state's estimate of the total amount those likely to apply for the funds will need. Indeed, agencies and institutions can be encouraged to apply without regard to the general need factors of the formula. In this situation the funding of all applicants, in the amounts that they seek, can indicate a disregard of the statutory fund distribution factors since the project pool has been set up to fund all who apply, irrespective of the fund distribution factors.

There is another situation in which all applicants are funded, but which does not necessarily create the same problems. Here the state invites certain applicants to apply (by a request for proposals) based on the applicants' scores on the formula ranking. Only those high need LEA's or OERs,which the amount of funds in the pool is likely to fully fund, are invited to apply. Here all applicants may be funded, but prior to receipt of applications low need applicants have been screened out based on need factors. It is our conclusion that the funding of all applicants in this situation is consistent with the fund distribution requirements because the effect is the same whether the ranking of LEAs or OERs is done to limit applications or to establish a cut-off for funding after applications are received. Both cases use a funding cut-off.[153]

A major deficiency in the present legal framework is that, while both Congress and ED appear to have contemplated that the applications approval cut-off would be used -- or a variable amount of VEA funds would be calculated -- in connection with the project method of funding so that not all who apply are fully funded, no legal standard for this cut-off has been adopted. As noted above, this omission has resulted in some states using the ranking of applicants for project funding as meaningless formality leading to the funding of all applicants, irrespective of need. Because the project method of funding is so open ended it is not difficult to manipulate to accomplish this result. Decisions concerning the amount of VEA funds to include in the project pool, restrictions on use of funds and the percentage of local matching required and behind the scenes encouragement to particular agencies or recipients to apply can help to ensure that the available funds approximately equal the requests for them, without the state having to make "hard choices" among recipients by actually using the ranking to fund applicants. Consequently, we have found that the legal framework relating to project funding is currently inadequate to prevent this disregard of the fund distribution factors under the project method of funding.

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[153] Under the present administration of the VEA it is, however, impossible to determine which of these three situations exists from a review of state reports. Consequently, we recommend that states report the ranking used for project funding and show on that ranking where the funding cut-off was made, either before or after applications were received. It is clear that this ranking is currently prepared by states in order to use the project method; thus this reporting requirement would not necessitate the collection of any new information.

We see several alternatives for addressing this problem. The first alternative requires a specific cut-off and the second requires variable VEA funding.

The first alternative for ensuring that states use the fund distribution factors in project funding is to require a cut-off at a specific point on the ranking of all potential applicants. A logical cut-off is at the state average score on the VEA fund distribution factors. Under the cut-off only applicants with above average need as shown by the RFA and low-income/higher cost student factors would be eligible for project funding. This cut-off is consistent with the congressional objectives to focus VEA funds on LEAs and post-secondary institutions having the greatest needs for vocational education. Under this alternative the state would fund applicants in the order of need and might run out of funds before reaching the applicant at the state average; the cut-off, however, would ensure that project funds are used by above average need applicants by not permitting the state to fund those applicants whose needs are below average in comparison to others.

A second alternative would be to use the VEA funds to establish a planning entitlement for each potential applicant, which is the basis for applicants submitting project proposals to the states. Under this method a cut-off would not be needed because the fund distribution factors are used to calculate a variable funding amount. The state, consistent with the assumptions of the project method, could require that applicants show that the total funds available for a project (including non-Federal) are sufficient to carry out the project. The amount of VEA funding would, however, be determined by the fund distribution factors.

The second problem, which is the inconsequential variation in percentage reimbursements under some of the projects we reviewed, would be remedied by our recommendation in section III of this chapter that a ratio parameter be placed on percentage reimbursements. As described in that section, the ratio parameter would require that the ratio variation in VEA percentage reimbursement among recipients not be less than the ratio differences in recipients' total factor scores. The example above which illustrated the project method of funding also shows how this ratio parameter would operate. In that example LEA 1 has a total factor score of 20, and LEA 3 has a score of 10. This is a ratio of 2 to 1. The percentage reimbursements under the project, which varies from 80% to 40%, also yields a variation of 2 to 1.

Depending on the type of project funding the state wished to use any of these three alternatives relating to an eligibility cut-off, a planning entitlement or a percentage reimbursement would carry out congressional objectives relating to the use of funds distribution factors in project method funding.

In addition we recommend that the formula override provisions recommended in section III for the direct allocation and percentage reimbursement methods of funding[154] also apply as exceptions to the above parameters on project funding. This would permit states to override the applicant approval cut-off or the variable allocations for projects based on objective criteria of specific need for vocational education, as defined in section III.[155]

This override provision permits states that (a) quantify the relative need for particular vocational education programs, services, facilities or equipment among recipients, (b) designate project funding pools to meet specifically defined needs, and (c) require applicants to use project funds to meet these needs, to fund applicants in rank order (determined by the VEA formula) without regard to the cut-off and variable amount requirements.

This override provision can be illustrated through an example. We will assume that the objective standard of need is the need for word processing equipment in each applicant's business education curriculum. Three LEAs are ranked by these formula factor totals. As in the example on page 127, supra they range from high need (LEA 1) to low need (LEA 3). However, in this example no local match is required so the total amount is sought from VEA funds. Each LEA proposes to use the whole amount for word processing equipment. The project funding pool contains a total of $85,000.

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[154] See p. 95 supra.

[155] See p. 95 supra.

	Factor Total	Project Amount Sought	Amount of VEA Funds Approved
LEA 1	20	$ 40,000	$ 40,000
LEA 2	15	$ 45,000	$ 30,000
LEA 3	10	$ 50,000	$ 15,000
		$135,000	$ 85,000

LEA 1 has no word processing equipment and needs the full $40,000 to have sufficient equipment for its business program. Based on this and on its position of first in rank order of need as determined by the formula it receives the $40,000 it requested. LEA 2 already has some word processing equipment. It needs only $30,000 to provide the same level of word processing equipment to its business education students as will be available in LEA 1, after LEA 1 purchases its equipment. Thus, based on an objective standard of need for such equipment, LEA 2 receives only $30,000. LEA 3, although less needy under the formula, has a particular need for at least $25,000 in such equipment to bring it up to the standard in LEAs 1 and 2. Consequently, it receives the remaining $15,000.

Absent the use of such objective need criteria, LEA 2 would have received the full $45,000 requested and LEA 3 would have received no VEA funds.

We recognize that the objective need criteria override of the fund distribution parameters we recommend here and in section III is not without problems in terms of possibly being manipulated to defeat the VEA's fund distribution objectives. On balance, however, we see this as a needed incentive to encourage states to identify the relative needs of LEA and post-secondary institutions with greater precision than in the past. If this in fact turns out to be simply an incentive to circumvent the fund distribution provisions, the override could be removed at a later time. In any case we recommend that ED be urged to monitor the effects of these recommendations, if they are incorporated into the VEA.

Special note should also be made of our recommendation in chapter 5 concerning the use of a required local match in funding new programs.[156] We recommend that a local matching requirement be prohibited when new programs are being funded, to give poor and wealthy agencies and institutions an equal ability to apply for such funds. This recommendation would mean that when new programs are funded by the project method, a variable percentage reimbursement could not be used.[157]

3. Integration of the Direct Allocation and Project Methods of Funding

The formula override provisions described above and in section III would eliminate some of the differences between the project and direct allocation percentage reimbursement methods of funding. In this subsection we will further expand on the formula override recommendations in terms of how they can be used to allocate funds for various VEA purposes.

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[156] See Chapter 5 at pp. 6-29.

[157] The percentage reimbursement method inherently requires a local match (unless state categorical funds are used) to pay for the percentage of the total not covered by VEA funds.

The override provisions described in section III would authorize states to deviate from formula parameters in the distribution of VEA funds based on objective criteria of specific need for vocational education programs or services. This would permit and perhaps encourage states to be more reflective about the relative need for particular programs, program components, and services among recipients and to encourage states to use VEA funds to expand access to vocational education and close gaps in services. This is encouraged by permitting states to fund applicants in the order of need (as in the project method) up to the amount necessary to meet the state's objective service criterion, e.g., a particular pupil to counselor ratio or availability of a particular program.

In summary, the formula override provisions honor state policy initiatives with respect to expanding or improving access to vocational education.

In contrast, the somewhat similar project approach is more attentive to locally initiated priorities. Project budgets are developed by applicants, rather than funding amounts being initially proposed by the state. But like the override provisions it also funds in the order of need determined by a ranking of applicants.[158/]

Some VEA purposes may be best met by encouraging local initiative to apply for particular project funds. Others

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[158/] Thus, the major contribution of the override provision based on this concept is that it breaks down some of the distinctions between direct allocations and projects.

are probably best served by encouraging an intentional state role that is concerned with equal access to high quality vocational programs throughout the state. In addition, it is our conclusion that whichever direction the state moves in this regard, general fund distribution factors are needed to determine the general relative financial and demographically determined needs of applicants, and that relative financial ability and low-income/higher cost student factors are appropriate for establishing such needs.

Our analyses and recommendations in this chapter have sought to identify problems in applying the legal framework for fund distribution to a variety of purposes. In our opinion the recommendations made in this chapter would substantially improve the potential of the legal framework both to ensure that congressional objectives in adopting the 1976 fund distribution requirements are met and to allow states greater flexibility in meeting their particular needs in vocational education.

CHAPTER 5

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CHAPTER 5

OTHER FISCAL REQUIREMENTS

I. Purpose and Organization

A. Introduction

In the preceding chapters, the two primary funding concepts of the VEA, the application approval priority criteria, and the funds distribution factors, were analyzed for their clarity, consistency and adequacy. The purpose of this chapter is to analyze three other fiscal requirements in the VEA:

(1) the requirements that states ensure that Federal VEA funds are matched with non-Federal funds;

(2) the requirements that states and recipients maintain their level of expenditures for vocational education from non-Federal sources; and

(3) the requirement that states assure that Federal funds are used to supplement not supplant state and local funds that would otherwise be available for vocational education.

These requirements differ from the application approval and funds distribution requirements discussed in chapters 2 through 4 of this part in that they do not directly govern the distribution of the Federal grant. Rather, these provisions impose limited requirements on how states and local recipients of VEA funds must account for and use non-Federal funds. Although not directly relating to VEA funds, these provisions, and their implementation by states, can have a substantial effect on the distribution of VEA funds to recipients and on the total allocation of vocational education programs throughout a state. A major focus of this chapter is on these effects.

This chapter is divided into four sections. This first section gives an overview of the Federal legal framework and describes the major findings, conclusions, and recommendations of the study.

Section II describes and analyzes the requirement that states ensure that VEA funds are matched on a dollar-for-dollar basis with state or local funds. This section analyzes the clarity, consistency and comprehensiveness of three matching requirements: (1) the match of the state-wide total of VEA funds spent for basic and program improvement grants, (2) the match for VEA expenditures for state administration and (3) the match of Federal funds expended for recipient supervision and administration of vocational education.[1]

Section III analyzes the maintenance of effort requirements. The VEA contains several maintenance of effort requirements: (1) states, LEAs and post-secondary institutions must maintain either the combined fiscal effort per student or the aggregate expenditure for vocational education from the preceding fiscal year; and (2) LEAs using VEA funds for work-study programs must maintain the level of the expenditures for work-study at not less than the average level of three preceding fiscal years.

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[1] Several matching provisions are discussed in other chapters. The separate matching provisions for national priority programs are considered in Chapter 8. The reduced match for consumer and homemaking programs in economically depressed areas is discussed in Chapter 2.

The third fiscal requirement, the state level nonsupplanting requirement, is analyzed in section IV. This requires that Federal funds be used to supplement and not supplant state and local funds that would, in the absence of Federal funds, be made available for the "uses" specified in the Act.

B. Major Findings, Conclusions and Recommendations

We conclude that an adequate legal framework for distributing VEA funds among recipients must clarify the relationship between those Federal funds and funds from other sources which are used for similar purposes. In the VEA legal framework, as currently written, the relationship between state and local resources and VEA funds is governed by the various matching, maintenance of effort and nonsupplanting provisions.

In general, we conclude that the matching requirements are not an essential feature of the VEA legal framework. Indeed because of the interpretation which permits states to impose the aggregate state-level match requirement on recipients, this requirement operates to defeat other important congressional objectives, such as assisting low-wealth districts provide quality vocational education programs and ensuring that new programs are provided by recipients having the greatest need for them.

The other two matching requirements, the match for Federal funds spent for state level administrative purposes and local administrative and supervisory purposes, operate so as to ensure a limited Federal role in state and local administration.

This represents a policy decision to authorize limited use of Federal funds for administrative purposes. We offer no recommendations concerning this but merely describe state officials' general observations that these requirements help to ensure that state and local officials and legislative bodies have a stake in the Federal vocational education program.

With respect to the maintenance of effort requirements (applicable to the state, LEAs and post-secondary institutions and applicable to LEA work-study programs), we found only the recipient-level maintenance of effort provision to be necessary. We found that the state-level maintenance of effort requirement serves no useful function under the VEA because this requirement is met simply by aggregating the vocational education expenditures from non-Federal sources made by recipients and had no effect on state policy respecting vocational education. A requirement that the state, in addition to the recipient, ensure that the level of vocational education expenditures is maintained is duplicative and meaningless.

The separate maintenance of effort requirement is an inappropriate requirement to be applied to an optional program use such as work-study because it operates as a disincentive to direct funds to that use. States and recipients are reluctant to describe work-study programs in state plans and reports or use VEA funds for them since this results in being bound not to decrease previous work-study expenditures. We recommend the elimination of this requirement from the legal framework.

In contrast, we found the recipient (i.e., LEA and postsecondary) maintenance of effort requirement to be clear and appropriate. It is at the recipient level that a maintenance of effort requirement is essential in order to assure that VEA funds do not simply replace previously provided state and local funds for vocational education. We recommend, however, that a specific exception be made to ensure that a recipient that is unable to sustain a previous fiscal level solely because of replacement of higher paid staff with lesser paid staff is not in violation of this provision, or that it be clarified that the "unusual circumstances" rule applies to this situation.

With respect to the non-supplanting requirement, we found the statutory language to be vague, and inadequate to perform its needed function in the Federal legal framework. This requirement has been appropriately interpreted to apply to distributions of state funds for vocational education that take into account the distribution of VEA funds among recipients. ED, however, has not disseminated this interpretation. We recommend that the statute be amended to reflect ED's appropriate interpretation of the supplement, not supplant requirement.

We found the nonsupplanting provision to be inappropriate at the local level. Because of recipient discretion to propose a variety of uses of VEA funds, and the VEA's priority for new programs, it would not be appropriate for the nonsupplanting provision to prevent recipients from terminating old programs, so long as overall effort for vocational education is maintained.

The present maintenance of effort requirement is more appropriate to ensure this. Consequently, a nonsupplanting provision relating to the "uses" of non-Federal and Federal funds is not needed at the recipient level.

II. Matching of VEA Funds With State or Local Funds

A. Overview and Organization

The VEA contains five provisions which require states to match the Federal VEA allocation. These matching requirements consist of:

(1) a dollar-for-dollar match of the total state VEA allocation for the basic and program improvement grants (subparts 2 and 3);[2]

(2) a dollar-for-dollar match of the set-aside funds for the excess costs associated with national priority programs;[3]

(3) an amount equal to 10% of subpart 5 consumer and homemaking programs in economically depressed areas and a dollar-for-dollar match for such programs in other areas;[4]

(4) a variable matching amount for a recipient's cost of supervision and administration of vocational education programs;[5] and

(5) a phased-in dollar-for-dollar match of state administration expenses.[6]

No match is required for Federal funds spent for cooperative education programs and exemplary and innovative projects in private schools, and subpart 4 special programs for the disadvantaged.[7]

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[2] Sec. 111(a)(1)(A) of the VEA (20 U.S.C. 2311(a)(1)(A)).

[3] Sec. 111(a)(1)(B) of the VEA (20 U.S.C. 2311(a)(1)(B)).

[4] Sec. 150(c) of the VEA (20 U.S.C. 2380(c)).

[5] Sec. 111(a)(1)(B) of the VEA (20 U.S.C. 2311(a)(1)(C)).

[6] Sec. 111(a)(2) of the VEA (20 U.S.C. 2311(a)(2)).

[7] Sec. 111(a)(1)(D) of the VEA (20 U.S.C. 2311(a)(1)(D)).

This section analyzes the clarity, consistency and adequacy of the provisions which require a state match for the basic and program improvement grants, the match for recipient administrative costs and the match of state administrative expenses. The excess cost match for national priority programs in economically depressed areas has been analyzed in other chapters, and will not be discussed here.[8]

The section is divided into three subsections. This subsection A gives an overview of the issues and describes our major findings, conclusions and recommendations. Subsection B describes the relevant Federal and state legal framework.

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[8] The excess cost match for national priority programs is analyzed in Chapter 8, VEA Funds for Special Needs Population, at pages 25-42. In this chapter, we conclude that Congress should repeal the excess-cost matching requirements if it also repeals the general matching requirements analyzed in this section. If it retains the general matching requirements, we recommend that it substantially modify the excess cost calculation for national priority programs, but that an appropriate excess cost measure remain part of the national priority program irrespective of whether the matching requirement remains or is eliminated. Chapters 2 and 4 describe our conclusions and recommendations with respect to the special reduced match for subpart 5 consumer and homemaking programs in economically depressed areas. As pointed out in those earlier chapters, the one-third set-aside for economically depressed areas does not assure that such areas receive more VEA funds than other areas. This results from the over-identification of areas as EDA under existing data. Consequently this set-aside serves no useful purpose. And rather than have a reduced match for subpart 5 programs in certain areas, we recommend that the matching requirement be eliminated for subpart 5 programs for the same reasons we recommend that the match be eliminated for subparts 2 and 3.

Subsection C details our findings, conclusions and recommendations with respect to the matching requirements.

We have found that the present dollar-for-dollar state level match of the basic and program improvement and supportive service grants serves no important purpose in the VEA and, as implemented by states, conflicts with VEA objectives.

All states we reviewed substantially overmatched their Federal grant of VEA funds with state and local expenditures for vocational education. This meant that compliance with the general matching requirement was largely an accounting exercise. However, the method by which every state we reviewed ensured that matching funds would "balance" VEA funds was to pass the matching requirement on to local recipients. And the states' imposition of this matching requirement on recipients was largely insensitive to their relative fiscal ability. Further, this state-imposed local match is particularly a problem for fiscally constrained recipients when applied to VEA funding of new programs. In this regard we found the VEA prohibition on states imposing a local match for new programs on fiscally constrained recipients "making a reasonable tax effort" to be wholly ineffective.

In summary, the general state-level matching requirement for subparts 2 and 3 appears to serve no useful function under the present VEA structure. It does, however, interfere with the fund distribution objectives of the VEA to equalize vocational education opportunities among recipients and with the priority for new programs.

In contrast, we found that some state vocational education administrators consider the match for state and recipient administrative expenses a useful requirement. They believe that the requirement of shared administrative expenses ensures that state and local legislative and administrative bodies are involved and have a stake in the administration of Federal vocational education programs. In most of our study states these matching funds for state administration were to be the only state funds appropriated by the state legislature over which state vocational education administration had any discretion. Two of our four states did not have state categorical programs for vocational education. This meant that state funds used by recipients for vocational education are frequently allocated as general purpose funds. Although several states have cost adjustments for vocational education in their general state aid formulas, funds generated are not earmarked for vocational education. These facts mean that in many states the only direct and earmarked contribution state legislatures made to vocational education is the match for state administration. And state vocational educators are apprehensive that without it they would be perceived as too oriented toward Federal programs.

We simply report state comments on this matching requirement and make no recommendations on the match for state administration.

B. Federal and State Legal Framework

1. General Requirements

By regulations all state and local funds applied to matching requirements are subject to the conditions and requirements of the Act, regulations, and five-year State plan and annual program plan, and any programs or activities supported in whole or in part with matching funds must meet these requirements.[9]

Federal administrators have been consistent in requiring that the state match be met with only actual expenditures of state and local funds; i.e., state and local funds may be considered as matching funds in the year they are obligated and expended.[10] In-kind contributions, such as tuition fees, are not acceptable at either the state or local level, nor, in general, are other Federal funds.[11]

Further, ED has permitted both state and local funds to be included to meet the state's match under the VEA and prohibited state funds from being used to match Federal funds for more than one Federal program.[12] The state is required to report on its compliance with the matching requirements in its five year state plan,[13] annual program plan,[14] and accountability report.[15]

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[9] 34 C.F.R. 400.301(b) and (c).

[10] 34 C.F.R. §400.301(d) Interpretation in letters from Charles H. Buzzel, Acting Deputy Commissioner, BOAE to Gwendolyn Kean, Commissioner of Education, Virgin Islands Department of Education (January 18, 1978) and to Homer E. Edwards, Senior Program Officer, VTE, Region V -- Chicago (January 11, 1978).

[11] 34 C.F.R. §400.301(d) and Comment, 42 F.R. 53876 (Oct. 3, 1977). Tuition fees also may not be used to meet the matching requirement.

2. The Match for Subparts 2 and 3

In general, the current VEA requires that states match Federal VEA funds on a dollar-for-dollar basis for subpart 2 basic and subpart 3 program improvement and supportive services grants[16], for the cost of state administration[17] and on a proportional basis for the costs of supervision and administration by recipients.[18] This one-to-one matching ratio of Federal funds for basic and program improvement grants to state and local funds was carried over from the pre-1976 Act.[19]

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[12] OVAE Legal Opinions Handbook at p. 156 (Nov. 22, 1978).

[13] 34 C.F.R. §400.186(d).

[14] 34 C.F.R. §400.222(d).

[15] 34 C.F.R. §400.241(a)(3).

[16] Sec. 111(a)(1)(A) of the VEA (20 U.S.C. 2311(a)(1)(A)).

[17] Sec. 111(a)(2) of the VEA (20 U.S.C. 2311(a)(2)).

[18] Sec. 111(a)(1)(C), (20 U.S.C. 2311(a)(1)(C). This provision requires a dollar-for-dollar match for Federal funds used for the recipients' administrative and supervisory expenses, *if* the match is met by the state.

If the state does not fund this match VEA funds for local administration and supervision are limited to percentage of such costs which does not exceed the percentage of the total costs of the recipients' vocational education costs paid for under the VEA.

[19] *See* Sec. 125(a) of the VEA of 1968 (P.L. 90-576)(20 U.S.C. 1282(a)).

3. The Restriction on Imposing a Match on Recipients in the Funding of New Programs

The VEA prohibits states from denying funds "to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."[20]

The 1976 Amendments repeated the substance of this prohibition which was contained in the 1968 Act.[21] The Senate Bill proposed to eliminate the reference to "reasonable tax effort."[22] Any reduced match pursuant to this requirement would not reduce the aggregate state-wide match for subparts 2 and 3, but this, according to the Senate Report, would not effect the state's ability to meet its one-to-one overall match given the healthy national overmatch of state to Federal funds. However, it would "put poor districts and institutions on the same footing as the more affluent ones in making application for new Federal funds." The Senate, however, receded to the House in conference.[23]

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[20] Sec. 106(a)(5)(b)(ii) of the VEA (20 U.S.C. 2306(a)(5)(b)(ii)).

[21] Compare the 1968 VEA (P.L. 90-576) Sec. 123(a)(6)(G)(20 U.S.C. 1263) with Sec. 106(a)(5)(B)(ii) of the VEA as amended in 1976 (20 U.S.C. 1306(a)(5)(B)(iii)). The 1968 version stated that:

> "no local educational educational agency which is making a reasonable tax effort, as defined by regulations, will be denied funds for the establishment of new vocational education programs solely because the local educational agency is unable to pay the non-Federal share of the cost of such new programs."

The 1976 VEA requires that:

> "the State will not deny funds to any recipient which is making a reasonable tax effort solely because such recipient is unable to pay the non-Federal share of the cost of new programs."

These provisions are also discussed in Chapter 4.

[22] "[T]hat no eligible recipient will be denied Federal funds for the establishment of new vocational education programs solely because of its inability to pay the non-Federal share of the cost of such programs." S. Rep. No. 94-882 at 71.

ED has not interpreted this provision, and ED regulations merely repeat the statutory prohibition.[24]

4. The Match for State Administration

The statutory provision governing the match for state administration is as follows:

> The Commissioner shall pay, from each State's allotment under section 103 from appropriations made under section 102(a), an amount not to exceed the Federal share of the cost of State administration of such plans.
>
> (B) For the purpose of this paragraph, the Federal share for any fiscal year shall be 50 per centum, except that (1) for fiscal year 1978 it shall be 80 per centum and for fiscal year 1979 it shall be 60 per centum, and (2) whenever the Commissioner determines in exceptional circumstances that for the latest fiscal year for which reliable data is available preceding fiscal year 1978 State and local expenditures for vocational education in a State exceed ten times the Federal expenditure for vocational education in that State, and that the State has an appropriate, economic, and efficient State administration of the program, the Commissioner shall set the Federal share for fiscal year 1978 for that State in excess of the Federal share specified in clause (1), but not to exceed 100 per centum.

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[23] H.R. Conf. Rep. No. 94-1701 at 219.

[24] 42 C.F.R. 400.141(f)(5)(B)(ii).

Prior to the 1976 amendments, the VEA permitted Federal funds to be used at a level determined in the state plan for state administration.[25] These funds were required to be matched on a one-to-one basis with state or local funds.[26]

The 1976 amendments limited the amounts of funds for state administration by appropriating a fund of $25 million a year to be the sole source nationally for the Federal share of state administration of vocational education.[27] This amount was required to be matched by FY 79 dollar-for-dollar with State funds.[28]

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[25] Sec. 122(b) of the VEA of 1968 (P.L. 90-576)(20 U.S.C. 1262 (b)).

[26] Sec. 124(a) of the VEA of 1968 (P.L. 90-576)(20 U.S.C. 1264 (a)).

[27] Sec. 111(a)(2) of the VEA of 1976 (P.L. 94-482). This provision permitted Federal funds to be used for 75% of the state expenditures for state administration in 1978 and 50% thereafter. Both the House and Senate reports in 1976 recommended limitations on the previously unlimited use of Federal funds for state administration. Both houses were responding to a GAO report which showed that some state agencies were being totally supported from Federal funds and others were using these funds to support a very high percentage of administrative costs. H.R. Rep. No. 94-1085 at 46-47. The Senate Report quoted the same GAO Report to say that "this proportion of Federal funds spent for administration has been growing at a greater rate than the proportionate increase in Federal funds." S. Rep. No. 94-882 at 79. The Senate Bill proposed that states be permitted to allocate any amount of Federal funds for administration if they "demonstrated their commitment to the quality of such administration by also committing their own funds to match the Federal contribution," with a three year phase-in. The Senate also proposed to permit the Secretary to set a higher proportion of Federal funds for states which committed twice the national average percentage of state and local funds for administration.

[28] This did not include the costs involved in preparing the five-year plans, the annual plans and the accountability reports which were intended to be 100% Federal funded.

Federal administrative regulations for the matching of state administrative expenditures essentially track the statute, with the additional requirement of an 80/20 ratio of VEA funds from subparts 2 and 3.[29]

ED also interpreted the phase-in of the 50% state match to require states to match any administration expenses paid for with funds carried over from a previous year at the next year's higher rate.[30]

"Administration", defined in the statute as "activities of a state necessary for the proper and efficient performance of its duties under this Act, including supervision, but not including ancillary services,"[31] has been interpreted to include: supervision, planning, evaluation, data collection, reporting, monitoring, approved indirect costs, and general administration.[32]

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[29] 42 C.F.R. 400.306. The Senate required that 80% of the Federal funds for state administration be taken from subpart 2 and 20% from subpart 3 to "prevent administrative expenses from being disproportionately charged against a single program activity." The regulations also expand upon the exceptional circumstances under which the Commissioner may waive the requisite match in FY 78.

[30] BOAE/DSVPO Policy Memorandum from Buzzell to Edwards Re: Federal Share of State Administration (Jan. 11, 1978).

[31] Sec. 195(20) of the VEA of 1976 (20 U.S.C. 2461(20)).

[32] Letter from Bennion (BOAE) to Barrett (Cal.) Jan. 12, 1978.

5. Match for Local Administration and Supervision

Under statutory provisions concerning Federal and state/local shares of local administration the Secretary shall pay to each state for grants to eligible recipients an amount not to exceed:

> "a part of the costs of supervision and administration of vocational education programs by an eligible recipient, except that such payment shall not exceed (i) a percentage of such costs equal to the percentage of the total costs of the vocational education program of such eligible recipient paid for from this section, or (ii) 50 per centum of such costs if the non-Federal share of such costs is paid by the State from appropriations for such purpose."[33]

The 1976 amendments to the VEA were silent as to the use of Federal funds for local administration and supervision because the bill sponsors were unable to work out an appropriate limitation.[34] The present provision was added by the 1977 Technical Amendments to the VEA. The House Bill authorized local recipients to use VEA funds for local administration, but prohibited them from spending "more in Federal funds for local administration than [they receive] in Federal funds for the total support of their program.[35]

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[33] Sec. 111(a)(1)(C) of the VEA (20 U.S.C. 2311(1)(c).

[34] See Sec. 111(a)(1) of the VEA of 1976, P.L. 94-482. (20 U.S.C. 2301(a)(1)). Cong. Rec. H2361 (daily ed. March 22, 1971) (Remarks of Cong. Perkins.

[35] Id. The example was given: "if a school district receives 10 percent of its vocational education funds from the Federal Government, it can pay for up to 10 percent of its cost of local administration from these Federal funds."

The concern expressed was "that poorer districts would receive proportionately more Federal help, and of course, would need proportionately more outside support for administration," and to limit the amount of Federal funds used for administrative purposes.[36] The Senate approved this amendment, but added the alternative measure of a dollar-for-dollar match if the state appropriated funds to pay for local administrative expenses.[37]

While largely tracking the statutory language, ED regulations clarify several points concerning the computation of the amount of the required match. The percentage of Federal funds applied to local administration and supervision may be "no greater than the percentage of Federal funds used to support the total vocational education program carried out by the local recipient."[38] To qualify for the exception permitting a dollar-for dollar match, state funds used for local administration must be "specifically made available" for that purpose

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[36] Id.

[37] S 7620.

[38] 42 C.F.R. 400.307(b)(1). The regulations also provide two examples of the operation of this computation. "For example, the total cost of the vocational education program of the eligible recipient is $100,000 and the Federal contribution to this eligible recipient is $25,000, or 25% of the total. If local administrative costs are $10,000, then up to 25% of this amount, or $2,500, may be charge against the Federal funds."

"from a specific State appropriation."[39]

The regulations also clarify that although 80% of the Federal funds used for local administration and supervision are to be taken from funds appropriated for subpart 2 and 20% for subpart 3, the state has discretion to "use its administrative funds in whatever proportion meets its needs."[40]

6. State Legal Framework

Of the four states in our research sample, two shifted all the state-level aggregate matching requirements for subparts 2 and 3 onto local recipients. The other two states shifted part of the match to recipients. In the two states in which local recipients picked up the whole match, each recipient was required to match VEA funds use-by-use, as well as overall.

In many cases the matching requirement is an integral part of the VEA fund distribution mechanism. The clearest example of this is the percentage reimbursement method of funding, described in Chapter 4. Under this method the VEA fund distribution factors are used to vary the portion of same total cost that will be paid from local funds (the local match) and from VEA funds.

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[39] 42 C.F.R. 400.307(b)(2). The following example is provided in the regulation to illustrate this: "For example, if the total cost of local administration is $10,000, then up to $5,000 may be charged to the Federal funds as long as the State contributes the same amount from a specific State appropriation."

[40] 42 C.F.R. 400.307(d).

Under the percentage reimbursement mechanism used by one state for post-secondary programs the VEA portion of approved vocational education costs varies from 40% to 60%; and conversely the local match varies from 60% to 40%. The most needy recipients under the formula must match 40% of the costs with their own funds (state-local) and receive 60% of the cost from the VEA. This is a typical pattern. States often create percentage reimbursement ranges that have an average match of about 50%, which assures the state that when all VEA funds are distributed for a particular use the sum of all recipient matching funds will approximately equal the amount of VEA funds distributed under that formula thereby assuring that the 50/50 match is met.

States also vary the range of the match from program to program. For example, one state has about 20 different funding pools, each for a different purpose, and each having a different variable match ranging from 60%-70% local matching funds in one pool to 0%-10% local funds in another. Here the amount of funds distributed through each pool and the variation in each method was calculated so that when all funds were distributed the aggregate local match required under all funding pools would total the amount of VEA funds which the state needed to match from recipient sources.

States using the project method of funding for some purposes also often use a percentage reimbursement feature in connection with project funding. This works the same way as described above. A total project amount is approved for funding and the state picks up part of the costs from VEA funds and the recipient must pay for part from local and state funds. Several states use their formula to calculate a variable percentage match for projects, e.g., 40%-60% local matching funds. Another state requires a flat 50-50 match for all recipient projects, irrespective of recipient need and fiscal ability, except for projects for new programs where a variable match of from 40%-60% is required.

One state which uses its formula to directly allocate a variable amount of VEA funds to recipients does not use the formula to calculate a variable match. But because a one-for-one match is required for the VEA funds each recipient receives, this operates, in fact, as a variable match. This imposes a higher match on poorer and more needy recipients because they receive proportionately more VEA funds. For example, a needy LEA may receive $100 per vocational student in VEA funds. It is required to match that with $100 per student in state and local funds -- a less needy LEA may receive only $30 per student and its match is only $30 per student.

Only two states had a state categorical program for vocational education and both of these integrate those programs with the VEA program to assist in meeting matching requirements. One state that does integrate state and VEA funds has sufficient state categorical funds for vocational education to meet the VEA matching requirement, but it also requires a local match ranging from 26% to 32% of a recipient's state calculated cost of vocational education (including VEA, state and local funds). Exceptions are made for disadvantaged and post-secondary funds under subparts 2 and 3 which are matched with state funds.

With respect to the VEA prohibition on denying new program funds to recipients that are unable to meet the match and that are making a reasonable tax effort, no state we reviewed took any special action to meet this requirement. State interviews indicated that state officials doubted that applicants could demonstrate that any denial of new program funds was "solely because such recipient is unable to pay the non-Federal share..."[41] This is because the total amount of state and local funds spent on vocational education even by poor applicants, is so much greater than the amount of VEA funds received that the causal relationship between applicant priority and failure to apply for new program funds would be hard to establish with certainty.

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[41] Sec. 106(a)(5)(B)(ii) of the VEA (20 U.S.C. 2306(a)(5)(B)(ii).

Only one state in our survey encountered difficulty meeting the match for state administration. Prior to the 1976 VEA Amendments, this state used no state funds for vocational education administration. In FY 78, the state was granted a waiver of the matching requirement by ED. In order to meet the requirement of a 40% state match in FY 79, this state reduced its vocational education administrative staff by about one-quarter. We were told that the state finance department and legislature resisted appropriating additional funds and attempted to force administrative staff into ancillary activities to qualify for non-matched funding.

C. Findings, Conclusions, and Recommendations

Overall, we found the matching requirements to be clear and understood by states.

1. State-wide Aggregate Match

We found that none of the states in our survey encountered any difficulty meeting the aggregate state-wide match of VEA funds because state and local funds for vocational education in each state were significantly greater than the amount of VEA funds.

The problems we identified with the aggregate state match resulted from states passing this requirement on to local recipients. We found that this practice was necessitated in some states because they do not have separate state funds earmarked for vocational education. Rather, state funds are distributed through a general state aid formula and locals decide how much to use for vocational education. In these states, passing the match on to local simplifies accounting for vocational education funds and ensure that the overall state match is met.[42]

This match pass-through also results from the states having to give an assurance that state and local funds used for the match meet VEA requirements.[43] States feel constrained to identify the state and local funds to which this requirement applies.

The one state which did not completely pass this match on to the locals has a large state categorical program for vocational education from which to meet the requisite match.

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[42] Typically revenues and expenditures of LEA's are not accounted for by program, and expenditures are not accounted for by source, e.g., fiscal reports show a line item for "instructional staff" but are not separately reported for the vocational education program." States know that state and local funding for vocational education substantially overmatch VEA funds but the standard accounts used by LEAs and states cannot identify these funds.

[43] C.F.R. §400.301.

Because this state's vocational education funds are significantly greater than Federal VEA funds allocated to the state, it could meet its aggregate match with state aid. But this state also requires locals to share in the match, thereby seeking to free additional state funds from VEA requirements. This has three effects. First, it enables the state to keep most of its funds from being incumbered by Federal standards.[44] Second, it requires locals to be involved financially in the Federal vocational education program. Third, it facilitates the tracking of the special expenditures and excess cost provisions.[45]

Passing the state match on to recipients can have a perverse effect on the distribution of VEA funds. This is particularly true when a one-for-one local match is attached to a direct allocation of VEA funds, as is the case in one of our states. Here the more needy recipients receives more VEA funds than less needy recipients but also have a proportionately larger match. The percentage reimbursement method of funding as used in several other states has the advantage of reducing the match for more needy recipients, but the variation in the local match is so small as to be insignificant in most cases, e.g., 45%-55%.[46]

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[44] Although matching funds are not required to be distributed through Federal funding formulas, any state matching funds used, for example, for cooperative education must meet the numerous Federal requirements for cooperative education one state funds a large cooperative education program with non-matching state funds, and by requiring locals to meet most of the match, is able to keep its cooperative education program outside Federal standards. Although ED regulations also subject state and local funds used for maintenance of effort to VEA requirements, it appeared that states do not take this as seriously as the application of VEA requirements to matching funds.

[45] Several states noted they could thereby ensure that national priority program matching requirements were met (discussed in Chapter 8).

The pass-through of the state match to recipients has the greatest adverse consequences on high need applicants, when this is done in connection with the funding of new programs. Unlike program maintenance expenditures, which most districts easily meet out of existing appropriations, imposing a local match for new programs puts the applicants whose revenues are most constrained at a competitive disadvantage. This, in combination with the necessity of then assuming the new program expenses in the next year, operates to discourage low wealth districts from seeking new program funds or applying for the amounts that they need. Yet because these applicants are fiscally disabled they may have the greatest unmet needs for new programs.

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[46] Furthermore, if wealthier recipients are able to prepare larger vocational education programs, they will end up with greater benefits because they will qualify for a greater amount of reimbursible costs. The ratio parameters recommended in Chapter 4, Section 3 would substantially reduce this problem of requiring that the variation in percentage reimbursements be proportional to the range of total factor scores for recipients. The compression of the range of variation to insignificance was particularly a problem when states used the percentage reimbursement method of funding either as a separate method or in connection with the project method. Here there appeared to be a uniform tendency of states to move as close to a uniform reimbursement as possible.

Such considerations underly the VEA prohibition on denying new program funds to recipients making a reasonable tax effort that are unable to pay the non-Federal costs.[47] However, this prohibition has been totally ineffective.

Based on these findings we conclude that the required state-wide match, as interpreted to permit states to pass the matching requirement on to recipients, serves little useful purpose in the VEA and is, in fact, counter-productive. Given the significant overmatch of state and local funds for most VEA purposes, this provision is no longer needed to assure state and local participation in the funding of vocational education. While this may be true for particular uses, such as vocational education programs for disadvantaged and handicapped students, this is not the case for the general vocational education program in any state in our research.

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[47] Sec. 106(a)(5)(b)(ii) of the VEA (20 U.S.C. 2306(a)(5)(b)(ii)).

But most importantly, the imposition of this matching requirement, which is passed on to local recipients, operates to disadvantage the least fiscally able in contradiction of Congress' clear intent to increase their capacity to offer vocational education. Consequently, we recommend that the state-wide match for VEA funds under subparts 2, 3 and 5 funds be eliminated.

Although Congress could eliminate the most problematic feature of the state matching requirement by prohibiting states from imposing a match on recipients, we conclude this is not a workable or wise policy. A prohibition on passing through the state match to recipients probably would require states to enact categorical state funding programs for vocational education. First, this would not necessarily increase the amount of state funds for vocational education since such a program might simply take funds from other state general aid programs for education. Second, state categorical programs often do less to equalize for the disparate fiscal needs of recipients than do state general aid programs. Thus, requiring states to adopt additional categorical programs could be a step backwards in terms of the congressional objective under the VEA of equalizing for the differing financial abilities of recipients. Third, many states believe that local districts should contribute their share for these "free" Federal and state dollars. In many states, this affords the state a better opportunity to be involved in the planning of the total vocational education program. Fourth, the local match does not appear to be a serious problem in the funding of continuing vocational education programs because even the poorest recipients probably substantially overmatch VEA funds. Consequently, we do not recommend that the VEA prohibit states from imposing a match on recipients -- except for new programs.

As discussed above, the prohibition on denying new program funding to recipients making a reasonable tax effort "solely" because they are unable to meet the local match, has been totally ineffective to accomplish the intended objective of eliminating financial barriers to new program funding in fiscally disabled recipients. One problem with this provision is that it does not track the methods states actually use to fund new programs. Even where states have new program funding pools, the problem for poor recipients is not the "denial" of funds as much as the imposition of matching and single year conditions which deter them from applying or result in a scaled-down request.[48] And even fiscally disabled recipients would have difficulty bearing the burden of showing that their fiscal problems are the sole reason for their inability to fund the match. A state can always respond to the argument by suggesting that the recipient divert funds from an existing program.

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[48] The problem of single year funding is the subject of a recommendation, made in Chapter 2, to permit new program funding for 3-5 years. This expanded time frame is particularly needed if a state requires a local match for continuing programs where new programs are 100% VEA funded.

Consequently, we recommend that if Congress intends to give priority to new programs,[49] it prohibit states from imposing a matching requirement on recipients when VEA funds are used for new programs.

2. The Matching Requirements for State and Local Administration and Supervision

The comments of state officials concerning the required match for state administration and supervision are set out in the introduction to this chapter and are not repeated here.

We did not identify substantial current problems concerning the clarity and consistency of either the match for state administration or for local administration. We make no recommendations regarding this.

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[49] _See also_, the discussion in Chapter 2 and 4 on new program funding.

III. Maintenance of Effort

A. Overview and Organization

The purpose of this section is to analyze the clarity, consistency and adequacy of the three sections of the VEA which prevent states and recipients from reducing their past levels of vocational education funding.

The Federal and state legal frameworks will be described in subsection B. Subsection C contains our findings, conclusions and recommendations.

The VEA maintenance of effort provisions apply to LEAs and post-secondary educational institutions and states and requires that they maintain either their fiscal effort per student or their aggregate vocational education expenditure.[50] The VEA also contains a separate maintenance of effort requirement for LEA work-study programs, when VEA funds are used for such programs.[51]

In general, we found the recipient (i.e., LEA and post-secondary) maintenance of effort provisions to serve the needed purpose of helping to ensure that recipients do not reduce their fiscal commitment to vocational education as a result of receiving VEA funds. We recommend they be retained with a limited exception to ensure that recipients which are unable to sustain previous fiscal levels solely because of the replacement of higher paid staff with lesser paid staff are not in violation of this provision or clarification that the "exceptional circumstances" rule applies to the situation.

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[50] Sec. 111(b)(1) and (2) of the VEA of 1976 (20 U.S.C. 2311(b)(b)(i)).

[51] Sec. 121(a)(5) of the VEA of 1976 (20 U.S.C. 2331(a)(5)).

We were unable to identify any parallel purpose served by the state-wide maintenance of effort requirement. In general we found that this requirement was met by states summing the amounts spent by local recipients on vocational education from state and local funds, and had no effect on the funds raised for vocational education at the state level. Indeed, only two of our four study states separately appropriated state funds for vocational education. Thus we see little purpose for the state-wide maintenance of effort requirement.

With respect to the special maintenance of effort requirement for work-study programs, we found that it was viewed in most states as an unnecessary provision and as a meaningless legacy of earlier VEA enactments which treated work-study as a separate categorical program. Furthermore, the imposition of this additional condition on what is now a discretionary use of VEA funds probably inhibits the use of VEA funds for this purpose -- directly contrary to congressional intent. We recommend that this additional requirement applicable to work-study be eliminated from the legal framework.

B. Federal and State Legal Framework

The VEA prohibits the payment of any VEA funds to:

> any local educational agency or to any state unless the Commissioner finds, in the case of a local educational agency, that the combined fiscal effort per student or the aggregate expenditures of that agency and the State with respect to the provision of vocational education by that agency for the fiscal year preceding the fiscal year for which the determination was made was not less than such combined fiscal effort per student or the aggregate expenditures for that purpose for the second preceding fiscal year or, in the case of a state, that the fiscal effort per student or the aggregate expenditures of that State for vocational education in that State for the fiscal year preceding the fiscal year for which the determination was made was not less than such fiscal effort per student or the aggregate expenditures for vocational education for the second preceding fiscal year.[52]

A parallel provision exists for post-secondary institutions:

> No payments shall be made in any fiscal year under this Act to any postsecondary educational institution unless the Commissioner finds that the aggregate amount or the amount per student spent by such institution from current funds for vocational education purposes for the fiscal year preceding the fiscal year for which the determination was made was not less than such amount spent by such institution from current funds for the second preceding fiscal year.[53]

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[52] Sec. 111(b)(1) of the VEA (20 U.S.C. 2321(b)(2)).

[53] Sec. 111(b)(2) of the VEA (20 U.S.C. 2321(b)(2)).

The Act also requires LEAs which use VEA funds for work-study programs to:

> expend (from sources other than payments from Federal funds under this section) for the employment of its students (whether or not in employment eligible for assistance under this section) an amount that is not less than its average annual expenditure for work-study programs of a similar character during the three fiscal years preceding the fiscal year in which its work-study program under this section is approved.[54]

Similar maintenance of effort provisions were present in the VEA prior to the 1976 amendments, but these amendments made two changes: (1) the provision applicable to post-secondary institutions was added and (2) the previous measure of "combined fiscal effort" was expanded to "the combined fiscal effort per student or the aggregate expenditures of that agency and the State."[55]

The regulations issued in 1977 essentially repeat the statutory language[56] but include two additional interpretations. First, the regulations adopted a "Five Percent Rule" which allows a 5% expenditure reduction without violation of the requirement. This rule was applied to all three maintenance of effort requirements.[57]

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[54] Sec. 121(a)(5) of the VEA (20 U.S.C. 2331(a)(5)).

[55] The House, which originated the second of these changes, explained its intention in expanding the measures of maintenance of effort to be "to permit decreases in expenditures where there are decreases in enrollments." H.R. Rep. No. 94-1085 at 33. The Senate bill would have permitted the Commissioner to "waive a portion of this requirement if available tax resources are reduced." Sen. Rep. No. 94-882 at 80. This was eliminated in Conference. H.R. Conf. Rep. No. 94-1701 at 224.

[56] 34 C.F.R. §400.321.

The regulations also interpreted the VEA amendments to allow a reduction in effort under certain unusual circumstances":[58]

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[57] The Five Percent Rule for State maintenance of effort is as follows:

> Total State fiscal effort for vocational education in the preceding fiscal year shall not be considered reduced from the fiscal year effort of the second preceding fiscal year unless the per student expenditure or aggregate expenditure in the preceding year is less than that in the second preceding fiscal by more than five percent. For example, a State which expends an aggregate of $10 million for vocational education in one fiscal year and an aggregate of $8,000,000 in the succeeding fiscal year will not be considered to have reduced fiscal effort for the purposes of the Vocational Education Act. 34 C.F.R. §400.323.

This rule was justified by ED on the basis that "fiscal effort" in the statute relates to tax effort and was intended to "take into account the relationship between tax rate and tax base." Consequently, if the tax rate remains steady, but the value of the tax base declines, the resulting decrease in the revenue yield is not considered a reduction of effort. Comment/Response 42 F.R. 53877 (Oct. 3, 1977). ED appeared to justify the Five Percent Rule as a proxy for the maintenance of fiscal effort where the tax base declines. Id.

[58] 34 C.F.R. §400.324.

> Any reduction in fiscal effort for any fiscal year by more than five percent will disqualify the State from receiving Federal funds unless the State is able to demonstrate to the satisfaction of the Commissioner the following:
>
> (a) In the preceding fiscal year, the reduction was occasioned by unusual circumstances that could have been fully anticipated or reasonably compensated for by the State. Unusual circumstances may include unforeseen decreases in revenues due to the decline of the tax base;
>
> (b) In the second preceding fiscal year, contributions of large sums of monies from outside sources were made; or
>
> (c) In the second preceding fiscal year, large amounts of funds were expended for long-term programs such as construction and acquisition of school facilities or the acquisition of capital equipment.

This is also applicable to all three maintenance of effort requirements. See 34 C.F.R. §400.327 and 400.330.

In 1980, the Secretary proposed to eliminate the permitted five percent reduction in maintenance of effort.[59] The basis for this proposal was the criticism of this policy by the House Committee and its urging that the Department revise the regulations.[60] At present, the five percent reduction policy is still in effect, as the proposed change has not been issued in final form.

The statute permits maintenance of effort to be determined either on the basis of aggregate expenditures or combined fiscal effort per study. ED has interpreted this to permit states and recipients to change the measure one year to the next.[61]

The state level maintenance of effort requirement refers to the "fiscal effort per student or aggregate expenditures of that State for vocational education..."[62]

Federal administrators have interpreted this to refer to all state and local funds expended for vocational education, including funds used for vocational education from local tax revenues and general state aid.[63]

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[59] Notice of Proposed Rule Making, 45 F.R. 28290, 28293 (April 28, 1980).

[60] H.R. Rep. No. 95-1137 at 40 (cited in 45 C.F.R. 28290, April 28, 1980).

[61] Question #22, 42 F.R. 53866 (Oct. 3, 1977).

[62] Sec. 111(b)(1) of the VEA (20 U.S.C. 2311(b)(1)).

State and local funds used to meet maintenance of effort requirements "are subject to the terms and conditions of the Act," but are not subject to the funds distribution requirements.[64] For example, states or recipients which fund cooperative education programs with state funds that are counted toward the maintenance of effort requirements must meet all the programmatic standards contained in the VEA, including the requirement that priority for cooperative education programs be given to LEAs in areas with high rates of school dropouts and youth unemployment.[65] Federal administrators also noted that even though the VEA fund distribution requirements are not applicable to maintenance of effort funds, the Federal civil rights statutes and regulations would be applicable if the result of the distribution "is less than an equitable distribution of state funds to priority eligible recipients."[66]

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[63] This policy interpretation is not written, but Federal administrators and states "understood" this to be the case.

[64] BOAE/DSVPO Policy Memorandum FY 79-3, Sept. 19, 1979 at 3.

[65] Id.

[66] Id. See, generally the substantive requirements for cooperative educational programs. Sec. 122 of the VEA (20 U.S.C. 2331). Although the memorandum discussed cooperative education, a consistent application would also require compliance with other additional requirements applicable to particular uses of VEA funds if a state or recipient applies its maintenance of effort funds to those purposes.

States reported having no problems meeting the state-wide maintenance of effort requirement. States applied both state and local funds to this requirement. This requirement is met by recipients reporting the amounts of state and local funds they expend on vocational education.

The only serious problem relating to recipient maintenance of effort identified by officials in several states was the difficulty of meeting this requirement when a higher paid vocational staff person is replaced by a lower paid staff person in a small school district. We were told that when vocational education programs are sufficiently small, the retirement of a staff person can throw the recipient out of compliance.

C. Findings, Conclusions and Recommendations

Overall, we found the three maintenance of efforts requirements to be clear and comprehensible to states. States generally understood what was expected of them and had little difficulty interpreting the requirements. We found, however, the maintenance of effort provisions to raise three basic issues:

(1) whether a state-level maintenance of effort requirement is needed in the VEA legal framework;

(2) whether the recipient-level maintenance of effort provisions is sufficiently flexible; and

(3) whether the special work-study maintenance of effort provision is needed in the current VEA?

These issues are explored below.

1. The State-Level Maintenance of Effort Requirement

At the state level, the maintenance of effort requirement applies to the aggregate of state and local funds used for vocational education, rather than merely state funds. Vocational education is not, however, a state program but is generally an aggregation of local programs. States meet the maintenance of effort requirement by totalling the amounts spent by local recipients on vocational education from state and local funds. However, recipients receiving VEA funds are also subject to a maintenance of effort requirement.

Under the present legal framework, the only thing the state-wide maintenance of effort provision appears to add is to ensure that LEA's and post-secondary institutions not funded under the VEA do not substantially reduce their effort for vocational education, since these are the only agencies and institutions that do have to meet the recipient maintenance of effort requirement. Even if many potential recipients did not receive VEA funds (unlike the current selection) we do not see a clear policy objective in regulating the expenditure levels for vocational education of potential recipients not funded under the VEA.

If states were required to meet maintenance of effort requirements from state funds alone, then state-wide maintenance of effort would have meaning in ensuring continued state commitment to vocational education. However, such a requirement would have the same undesirable side effects as those that would result if the matching requirement were similarly attached only to revenues from state sources.[67] States today fund local vocational programs through a variety of state aid mechanisms, not all of which are identified as vocational education funding mechanisms. While some states have specific categorical funding programs for vocational education or vocational student or program weightings in general state equalizing formulas, many states have no such programs and local school districts are expected to fund vocational education programs from general state funds. A requirement that MOE be met simply from state funds specifically earmarked for vocational education would, in our opinion, needlessly restrict state options to fund vocational education through general equalization formulas which do not specifically earmark funds for vocational education. We found maintenance of effort to be more appropriate as a requirement applicable to recipients that actually operate vocational education program. Furthermore, a recipient maintenance of effort requirement makes unnecessary a state-level maintenance of effort requirement under the present legal framework.

We therefore recommend the elimination of the state maintenance of effort requirement unless the state operates programs directly, and is considered a recipient.

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[67] *See* pp. 27-28 *supra*.

2. Recipient-Level Maintenance of Effort

It is recipients that make choices about increasing or reducing the amount of state or local funds for vocational education in light of the receipt of VEA funds. And if Congress intends that the level of state and local funds for vocational education should be maintained and not reduced when VEA funds are received, it is at the recipient level[68/] that such an intent should appropriately operate. Consequently, we found the recipient maintenance of effort requirements to be appropriate and necessary in the VEA legal framework.

Although our research did not include interviews with recipients, our interviews with state level staff included inquiries concerning the recipient maintenance of effort requirements. Several states indicated that declining enrollments, reductions in budgets and revenue limitation were forcing local recipients to reduce total expenditures for vocational education but that the per pupil expenditure measure and 5% reduction provision had allowed recipients to meet the requirement.

We were also informed that some recipients encountered problems meeting the maintenance of effort requirements when higher paid staff were replaced on lower paid staff, e.g., a teacher receiving longevity pay leaves and is replaced by a

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[68/] We recommend that a state, when using funds for its own programs or activities, be considered to be a recipient as to those funds.

lower paid teacher. This appears to be a problem particularly in small LEAs where such a reduction in staff salaries may reduce vocational expenditures, both total and per student, to below the level of the prior year and trigger a MOE violation. We were told Federal auditors initially challenged this as a MOE violation in one state but were ultimately persuaded that it was not. We believe this problem, which does not usually reflect an actual reducation in vocational education services, can be dealt with either by application of the unusual circumstances rule or by a specific exception. Such a specific exception could provide that a recipient that fails to maintain its fiscal effort solely because it replaces a higher paid staff member with an equivalent lower paid staff member shall not be in violation of this provision.

3. Work-Study Maintenance of Effort

The maintenance of effort requirement applicable to work-study programs funded under the VEA requires a LEA to expend on work-study programs not less than the amount of its average annual expenditure for work-study programs of a similar character during the three fiscal years preceding the fiscal year in which its work-study program is approved.[69]

While averaging prevents an LEA from having to fully reflect the higher funding for its work-study program in any single previous year, it still requires an LEA to maintain its future effort at a level that is not less than the average -- precluding any reduction in work-study funding to less than the average.

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[69] Sec. 121(a)(5) of the VEA (20 U.S.C. 2331(a)(5)).

This provision probably operates as an incentive to not offer work-study programs with VEA funds. The prior categorical requirements for work-study programs were carried over into the 1976 amendments when work-study was made a permitted rather than a mandatory use. However, we see no basis for singling this program out for different maintenance of effort treatment than other permitted uses, and consequently recommend it be eliminated.

4. Fiscal Crises and Maintenance of Effort

State and local fiscal crises resulting from tax or revenue limitation statutes or constitutional amendments could result in maintenance of effort problems. Although several of our states had such limitations imposed within the last few years, the maintenance of effort provisions, we were informed, had not been violated but some insecurity about future ability to comply was expressed. The MOE regulations contain an unusual circumstances rule, which, to our knowledge has not been applied by the Secretary. The application of this rule to violation of MOE resulting from such fiscal crises is unclear. We express no view on what response Congress should make except to point out that insofar as the objective of state tax base and revenue limitations is tax relief, an exception from MOE for such limitations would permit VEA funds to be used in place of state and local funds and might be an incentive to do so.

IV. Supplement, Non-Supplant Provision

A. Overview and Organization

The purpose of this section is to describe and analyze the VEA requirement that Federal VEA funds be used to supplement and not supplant state and local funds which would in the absence of Federal funds be made available for uses specified in the Act.[70] The non-supplanting requirement raises two issues:

(1) What is the meaning of "uses"; and

(2) How does the non-supplanting requirement operate in the total VEA framework?

Subsection B describes the Federal and state legal framework. Subsection C outlines in detail our findings, conclusions and recommendations.

Overall, we found the supplement, not supplant provision to be inadequately drafted to ensure that the VEA funds for vocational education are not used to supplant state funds which would otherwise be available for vocational education. It has, however, been adequately interpreted by ED on occasion, even though appropriate application of this interpretation has been overlooked.

We conclude that the phrase "state and local funds which would otherwise available for specific uses" should be replaced with the phrase "state and local funds which would otherwise be available for specific recipients."

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[70] Sec. 106(a)(7) of the VEA (20 U.S.C. 2306(a)(7)).

B. Federal Legal Framework

The non-supplanting provision in the Vocational Education Act requires:

> that Federal funds made available under this Act will be so used as to supplement, and to the extent practicable, increase the amount of State and local funds that would in the absence of such Federal funds be made available for the uses specified in the Act, and in no case supplant such state or local funds.[71]

The 1976 amendments to the VEA tracked the wording of the 1968 Act's non-supplant provision, except that it substituted the language "for the uses specified in the Act" for "from non-Federal sources for the education of pupils participating in programs and projects assisted under this title."[72] The substitute language was introduced in the House bill, but the reason for the change was not explained.[73]

The 1976 amendments to the VEA also deleted the "no penalization" provision of the 1968 Act which barred payment of any VEA funds "to a state which has taken into consideration payments under this title in determining the eligibility of any local educational agency in that State for State aid, or the amount of that aid with respect to the free public education of children during that year or the preceding fiscal year."[74]

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[71] Id.

[72] Sec. 141(a)(3)(B) and (C) of the VEA of 1968 (20 U.S.C. 241(e)).

[73] H.R. Rep. No. 94-1085 at 33.

[74] Sec. 143(c)(1) of the VEA of 1968, P.L. 90-247 (20 U.S.C. 241(g)).

The 1977 regulations simply repeated the statutory language of the non-supplanting provision of the 1976 amendments verbatim.[75] The only interpretation contained in the regulations appeared in a comment concerning the dollar-for-dollar match of the minimum percentage requirement for the disadvantaged:[76]

> Furthermore, the dollar-for-dollar matching provision required by section 110(b) of the Act for programs for the disadvantaged would seem to preclude any possibility of supplanting of funds. The statutory "non-supplant" provision in §106(a)(5) is designed to assure that the aggregate of State and local funds available for a specific purpose, such as the disadvantaged set-aside, is not reduced because of the receipt of Federal funds under the Act. Therefore, as long as the combined State and local funds match the Federal funds earmarked for the purposes of section 410(b), it is unlikely that a violation of the "no-supplant" requirement would occur.

The Office of General Counsel has explained that the purpose of the VEA non-supplanting provision is to assure that "the aggregate of state and local funds available for the purposes of the VEA is not reduced because of the receipt of Federal funds under the Act."[77] Based on this concept it found that a proposed state statute which would reduce a community college's state funds by the amount of VEA funds received violated the no-supplanting provision.

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[75] 42 C.F.R. §400.141(f)(6).

[76] 42 F.R. 53877 (Oct. 3, 1977).

[77] HEW Memorandum from Brustein, Office of the General Counsel to Cornelsen, Director BOAE (June 11, 1979). The statute in question specified that the state shall pay to community colleges... an amount equal to one-third of such colleges approved operating costs reduced by the amount of Federal funds and grants received by such community college."

C. Findings, Conclusions and Recommendations

We found the non-supplanting provision contained in the VEA to be vague and inadequate to ensure that Federal funds were used in a supplementary fashion.

Furthermore, it is not clear whether this provision operates at the state level, the recipient level or both. Since it refers to "State and local" funds without specification of the level, the appropriate interpretation appears to be that it operates at every level at which VEA funds could be taken into account in determining the amount of state and local funds available for VEA uses.

The Office of General Counsel has, however, adequately interpretated the non-supplanting provision to prevent a state from taking into account the distribution of VEA funds in determining the amount of state funds for vocational education a recipient will receive. This interpretation does not appear to have been widely disseminated or consistently applied, even though we found that this interpretation of the non-supplanting is essential for an adequate VEA legal framework: without it, the funds distribution provision analyzed in chapters 2-4 can be rendered meaningless.

We also found that at the recipient level the non-supplanting requirement is probably not necessary.

1. State Level Requirement

On its face, the non-supplanting statutue's reference to "uses", rather than "participants" or "programs: is confusing to states. The confusion is compounded by the overall structure of the 1976 VEA amendment which gave greater discretion to states about the uses of VEA funds removing some of the past categorical program restrictions.

The clearest explanation of the requirement appears in an unpublished interpretation by the Office of General Counsel. Under this interpretation states cannot reduce a recipients entitlement to state funds by the amount of VEA funds the recipient receives.[78] However, the interpretation has not been widely disseminated to states nor applied to situations in which it is appropriate.

We found that this interpretation is an important element of an adequate VEA legal framework because we discovered several problems that can arise when this concept of non-supplanting is not applied.

One state, which distributes categorical state vocational education funds through a formula which is separate from VEA funds, reduces the amount of such state funds in proportion to the VEA funds allocated to each recipient. This "backfilling" occurs as a result of the interconnection of the state and VEA formulas to distribute funds for vocational education in a manner which computes the state distribution after the Federal distribution. There is substantial variation in the allocation of VEA funds among recipients under the VEA formula.[79] However, recipients recieving more VEA funds receive fewer state funds, and conversely, so that the net result is a virtually uniform percentage reimbursement of vocational education costs from state and Federal funds. In this situation the VEA fund distribution factors of relative financial ability and low-income are meaningless since the additional VEA funds that these factors generate are taken away by the distribution of state funds..

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[78] See note 78, p. 45, *supra*.

With respect to VEA funding, this type of integration of VEA and state funds, which results from state board policy, may be somewhat unique because legislatures typically have not given state boards discretion to allocate the state vocational education funds. However, as a generic problem, this type of supplanting could also be accomplished through a statutory integration of VEA and state funds. Indeed, the proposed legislation which was the subject of the OGC interpretation did just this.

We also found that backfilling occurs in one state in the funding of post-secondary institutions. In this state, the legislature approves each institution's budget and the institution may not spend more than its approved budget. In the budget-making process each institution includes the amount of anticipated Federal funds. Through the budget process the

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79/ We described this in Chapter 4, however, as a formula which as a result of inappropriate interpretation of the VEA formula design requirements by ED fails to adequately take into account recipient size.

legislature then provides the differences between the amount of Federal funds and the institution's approved budget. Since the amount of state funds institutions receive is not fixed by formula, the legislature is free to take VEA funds into account in determining the amount of state funds they will receive. If during the year an institution receives more Federal funds than budgeted, the legislature also substracts the additional amount from the institution's next year's budget, as a carryover.

We recommend that the statute be revised to more precisely reflect ED's interpretation, i.e., states must supplement, not supplant the level of state funds for vocational education which would have been made available to eligibile recipients in the absence of VEA funds. In the alternative, Congress should consider re-incorporating the "non-penalization" provision which was part of the VEA until the 1976 amendments:

> No payments shall be made under this title for any fiscal year to a State which has taken into consideration payments under this title in determining the eligibility of any recipient in that State for State aid, or the amount of that aid, with respect to the free public education of children during that year or the preceeding fiscal year, except as permitted under this Act in determining the relative financial ability of applicants for funds under this Act.[80]

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[80] The underlined portion we recommend be also added to avoid any conflict between this provision and the definition of relative financial ability, which in certain circumstances takes into account the distribution of state funds. See Chapter 4.

2. Application of the Non-supplanting Requirement to Local Recipients

The applicability of the "non-supplant" provision to local recipients has not been clarified by ED. As discussed above, however, the language of the provision would almost have to apply at the recipient level since this is where decisions concerning "uses" of state and local funds were primarily made. But, again as earlier discussed, it would be anomalous for the 1976 amendment to give greater discretion concerning uses of VEA funds and at the same time restrict state and local uses - as long as a recipient's overall state and local effort for vocational education is not reduced.[81] Ensuring that the overall level of state and local effort for vocational education is maintained by recipients however, is the role of the recipient maintenance of effort provision in the VEA, previously discussed in this chapter. Consequently, we recommend that the VEA structure make clear that the supplement, not supplant requirement does not apply to local recipients since at this level it is redundant of the maintenance of effort requirement.

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[81] Monitoring the state and local funds devoted to particular uses within vocational education also appears virtually impossible without a revamping of most public education accounting systems, which do not now typically provide this level of detail.